

ROBERT C. LAWTON
County Manager

ANDREW D. REILLY
Executive Director

COUNTY COUNCIL

RICK MORELLI, CHAIRMAN
EDWARD BROMINSKI, VICE CHAIRMAN
JAMES BOBECK
KATHY DOBASH
HARRY HAAS
LINDA MCCLOSKEY HOUCK
TIM MCGINLEY
EILEEN SOROKAS
STEPHEN A. URBAN
STEPHEN J. URBAN
RICK WILLIAMS



County of LUZERNE
P E N N S Y L V A N I A
ESTABLISHED 1786

E-MAIL:
luzcoocd@luzernecounty.org

OFFICE OF COMMUNITY DEVELOPMENT
54 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2910 TDD: 570.825.1860

MEMO

TO: Mr. Robert C. Lawton, County Manager

FROM: Andrew D. Reilly

DATE: April 1, 2014

RE: Hotel Sterling Project Audit Issue Summary

Luzerne County and HUD have been engaged in a dispute for two years over a loan made in 2002 to City Vest, a local non-profit, which was used to buy and redevelop the former Hotel Sterling.

The dispute arose when the former County Controller wrote to HUD complaining of waste/mismanagement. HUD's Office of Inspector General (OIG) determined that all expenditures were for "eligible" activities. However, the OIG felt that funds were not "fundable" because low/moderate income jobs were not created at the site and thus concluded that the County should reimburse the Business Development Loan Program approximately \$6 million.

Since the audit determination, HUD authorized the City of Wilkes-Barre to demolish the Sterling Hotel with HUD Community Development Block grant funds, knowing full well that the asset (Sterling property) being destroyed was liened to the County in the amount of \$6 million. HUD never sought the County's input in this decision yet was fully aware of the background and the County/HUD financial interest therein.

Over the last two years HUD has cleared the County of two of the three findings in the audit however, they have not relented on the issue of reimbursing the loan fund. It is the County's opinion that HUD has ignored program regulations and jumped to the conclusion of a monetized settlement. HUD has not responded directly to points raised in writing by Luzerne County. The County also believes whoever made the monetization decision in HUD HQ was misinformed or unaware of what actually occurred. For that reason, we have requested a meeting with senior HUD HQ staff to fully set forth our position.

We request the attendance and support of our Congressional delegation, and would be happy to provide a technical briefing on this matter prior to the HUD meeting. The meeting request was submitted to HUD on January 30, 2014, and to date we have not been notified of a meeting date.



U.S. Department of Housing and Urban Development

Philadelphia Office
The Wanamaker Building
100 Penn Square East
Philadelphia, Pennsylvania 19107-3380

NOV 26 2012

Mr. Andrew D. Reilly
Executive Director
Luzerne County Office of
Community Development
54 West Union Street
Wilkes-Barre, PA 18711



Dear Mr. Reilly:

SUBJECT: Luzerne County, PA-Audit Report 2013-PH-1001

This letter serves as a follow up to the Audit Report issued on October 13, 2012 by the Regional Inspector General for Audit, Philadelphia Region.

The Office of Inspector General audited Luzerne County's administration of a \$6 million loan of Community Development Block Grant (CDBG) funds to CityVest to revitalize the historic Hotel Sterling and surrounding Projects. The Regional Inspector General for Audit determined that the County did not properly evaluate, underwrite, and monitor its loan to CityVest. They are recommending that HUD require the County to reimburse its business loan program \$6 million from non-Federal funds and that the County develop and implement comprehensive procedures for evaluating, underwriting and monitoring proposed projects.

We ask that a response to the recommendations described in the attached Audit Report be provided to this Office within 45 days from the date of the issuance of the audit report (October 31, 2012). If you have any questions or require assistance, please contact Ms. Ileana Colón, Senior Community Planning and Development Representative, at (215) 861-7656, or via email at Ileana.Colon@hud.gov. This Office may also be reached via telephone (TTY), by dialing (215) 656-3452.

Sincerely,

A handwritten signature in blue ink, appearing to read "Nadab O. Bynum".

Nadab O. Bynum
Director
Office of Community Planning
and Development

OFFICE OF AUDIT
REGION 3
PHILADELPHIA, PA



**Luzerne County Office of Community
Development, Wilkes-Barre, PA**

**Community Development Block Grant-Funded
Business Development Loan Program**

2013-PH-1001

OCTOBER 31, 2012



Issue Date: October 31, 2012

Audit Report Number: 2013-PH-1001

TO: Nadab O. Bynum, Director, Office of Community Planning and Development,
Philadelphia Regional Office, 3AD
//signed//
FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA
SUBJECT: Luzerne County, PA, Did Not Properly Evaluate, Underwrite, and Monitor a
High-Risk Loan

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG), final results of our review of Luzerne County, PA's \$6 million loan of Community Development Block Grant funds to CityVest to revitalize the historic Hotel Sterling and surrounding properties.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 215-430-6729.



October 31, 2012

Luzerne County, PA, Did Not Properly Evaluate, Underwrite, and Monitor a High-Risk Loan

Highlights

Audit Report 2013-PH-1001

What We Audited and Why

We audited Luzerne County's \$6 million loan of Community Development Block Grant funds to CityVest that was expected to be used to revitalize the historic Hotel Sterling and surrounding properties. We did the audit because HUD Office of Inspector General (OIG) audit report 2012-PH-0001¹ identified this long standing open Block Grant activity and because we received a citizen complaint alleging possible misappropriation of these funds. Our objective was to determine whether the County properly evaluated and underwrote its loan to CityVest and whether the project met its designated national objective.

What We Found

The County did not properly evaluate, underwrite, and monitor its loan to CityVest. After nearly 10 years and \$6 million expended, the project won't meet its designated national objective of job creation. The County and the City of Wilkes-Barre plan to demolish the hotel and clear the site although no permanent jobs were ever created. Therefore, the \$6 million in Block Grant funds expended for this project is an ineligible expenditure of taxpayer dollars. CityVest also used HUD funds inappropriately to make an unreasonable and unnecessary expenditure of \$303,000 to satisfy two municipal liens against a property that it had purchased. It was the responsibility of the former property owner to satisfy the liens.

What We Recommend

We recommend that HUD require the County to reimburse its business development loan program \$6 million from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project and that it require the County to develop and implement comprehensive procedures for evaluating, underwriting and monitoring proposed projects.

¹ "HUD Needed To Improve Its Use of Its Integrated Disbursement and Information System To Oversee Its Community Development Block Grant Program," dated October 31, 2011

TABLE OF CONTENTS

Background and Objective	3
Results of Audit	
Finding: The County Did Not Properly Evaluate, Underwrite, and Monitor a High-Risk Loan	4
Scope and Methodology	16
Internal Controls	17
Appendixes	
A. Schedule of Questioned Costs	19
B. Auditee Comments and OIG's Evaluation	20
C. Project Budget From Loan Application	32
D. Project Budget From Loan Agreement	33
E. Project Budget From Amended Loan Agreement	34
F. CityVest Expenditure Summary	35

BACKGROUND AND OBJECTIVE

Luzerne County, PA, is a Community Development Block Grant entitlement grantee. The U.S. Department of Housing and Urban Development (HUD) annually awards grants to entitlement grantees to carry out a wide range of community development activities directed toward revitalizing neighborhoods, economic development, and providing improved community facilities and services. The County consists of 76 municipalities, governed by a three-member board of commissioners. It manages its community development programs through its Office of Community Development located at 54 West Union Street, Wilkes-Barre, PA. The executive director of the Office of Community Development is Mr. Andrew D. Reilly.

The County's Business Development Loan Program is an economic development tool, funded by HUD's Community Development Block Grant program. The primary objective of the loan program is to stimulate economic growth in Luzerne County by providing financial incentives leading to the creation of new businesses or the expansion of existing businesses in the County, creating new employment opportunities and strengthening existing jobs, stabilizing or increasing the tax base, and increasing private investment. The County's board of commissioners, through the County's Office of Community Development, is responsible for the development, administration, implementation, monitoring, and evaluation of the loan program. The loan program provides low-interest financing to firms carrying out eligible economic development type projects meeting program objectives.

CityVest is a not-for-profit community development corporation, based in Wilkes-Barre, PA. Its mission is to undertake housing and commercial development projects to advance the economic revitalization of northeastern Pennsylvania's Wyoming Valley, particularly the downtown urban centers of Wilkes-Barre, Nanticoke, and Pittston. CityVest was founded in September 2000. In September 2011, its board of directors considered dissolving the organization. Board meeting minutes indicated that it did not dissolve at the urging of the County's board of commissioners.

On October 2, 2002, CityVest submitted an application to the County requesting a loan of \$4 million to revitalize the Hotel Sterling site, located in Wilkes-Barre, PA, including the surrounding properties. The County entered into a \$4 million, 20-year loan agreement with CityVest on November 6, 2002. The agreement required CityVest to create 150 permanent full-time-equivalent jobs with 80 of those jobs benefiting low- and moderate-income persons. In September 2006, CityVest requested an additional \$2 million loan for the project. On March 22, 2007, the County amended its loan agreement with CityVest and provided an additional \$2 million for the project. The revised agreement required CityVest to increase the number of permanent full-time-equivalent jobs to 175 and the number of those jobs benefiting low- and moderate-income persons to 90.

Our objective was to determine whether the County properly evaluated and underwrote its loan to CityVest and whether the project met its designated national objective.

RESULTS OF AUDIT

Finding: The County Did Not Properly Evaluate, Underwrite, and Monitor a High-Risk Loan

The County did not properly evaluate and underwrite its loan of \$6 million to CityVest. The project won't meet its job creation national objective. This condition occurred because the County lacked comprehensive procedures for evaluating and underwriting proposed projects before approving business development loans and did not properly monitor the project. The County's lack of objective evaluation and underwriting of the project and its lack of proper project monitoring contributed to \$6 million in Block Grant funds being spent on an incomplete project that failed to achieve its job creation national objective. The County believed its evaluation and monitoring procedures were sufficient. Since the project won't meet its designated national program objective, the related funds were ineligible program expenditures.

The County Was Responsible for Evaluating and Underwriting the Loan

The County was responsible for properly evaluating and underwriting its \$6 million loan to CityVest. HUD regulations at 24 CFR (Code of Federal Regulations) 570.209(a) provide the County guidelines designed to provide a framework for financially underwriting and selecting Block Grant-assisted economic development projects that are financially viable and will make the most effective use of Block Grant funds. The objectives of the underwriting guidelines include ensuring that project costs are reasonable; all sources of project financing are committed; the project is financially feasible; and to the extent practicable, Block Grant funds are disbursed on a pro rata basis with other finances provided to the project. However, the County's policies and procedures for evaluating and underwriting its Block Grant loans consisted solely of a single-page checklist that failed to adequately cover key HUD guidelines.

HUD's underwriting guidelines recognized that different levels of review may be appropriate to take into account the size and scope of a proposed project. Although the HUD guidelines for evaluating project costs and financial requirements are not mandatory, HUD expects recipients to properly evaluate and underwrite these loans. HUD expects recipients, when they develop their own programs and underwriting criteria, to take these factors into account.

Given that the \$6 million loan the County made to CityVest was by far the largest loan in its business development loan portfolio,² it was reasonable to expect the County to have conducted more than a cursory level of evaluation and underwriting before making the loan.

**The County Approved the Loan
Although the Project Lacked a
Plan**

In the description of the proposed project in its October 2, 2002, loan application, CityVest stated that “the exact future usage of the Hotel Sterling is unknown. CityVest intends to seek developers to assist and/or operate the site at a later date.” Despite these statements, the County entered into a \$4 million loan agreement with CityVest on November 6, 2002, or 35 days later.

**The County Did Not Ensure
That Other Project Funds Were
Committed to the Project**

The County did not ensure that all needed sources of project funding were committed at the time the loan agreement was signed. CityVest’s October 2, 2002, loan application showed that the budget for the project included the developer’s equity of \$850,000 and \$3.2 million in funds from other sources (see appendix C). A footnote at the bottom of the page stated that CityVest intended to seek funding from at least five other Federal and State sources. However, the same footnote also stated, “CityVest has not received approval for any of this funding yet.” The audit evidence showed, however, that CityVest never applied for \$2.2 million of the \$3.2 million it reportedly expected to obtain from other sources to complete the project.

In the November 6, 2002, loan agreement, 35 days after CityVest applied for the loan, the budget for the project again included the developer’s equity of \$850,000³ and \$3.2 million in funds from other sources (see appendix D). However, at the bottom of the page were five footnotes indicating that the sources of other funds were HUD, the U.S. Department of Commerce, the U.S. Economic Development Administration, the U.S. Environmental Protection Agency, and the Pennsylvania Department of Community and Economic Development. The County had documentation to demonstrate that CityVest received a \$1 million grant from HUD for the project at the time the loan agreement was signed. However, the grant was to be used for the Hotel Sterling project and another

² The County’s Business Development Loan Program portfolio as of February 29, 2012, consisted of 61 loans. There were 37 loans of \$500,000 or less, 10 loans between \$500,000 and \$1 million, 13 loans between \$1 million and \$3.6 million, and 1 loan that was greater than \$3.6 million—the \$6 million loan to CityVest.

³ Loan agreement exhibits A and B made CityVest responsible for the developer’s equity of \$850,000.

project. The grant agreement did not indicate the amount of funds CityVest would use for each project.

Lastly, the County's Business Development Loan Program Handbook stated that the program was intended to finance projects that would have a positive impact on the County by leveraging a significant amount of private investment.⁴ However, the planned financing for this project did not include private funds, although the president and chief executive officer of Guaranty Bank was a member of CityVest's board of directors.

**The County Did Not Properly
Assess the Feasibility of the
Project and Evaluate the
Project's Costs**

The County alleged that a feasibility study for the project was performed in 2001 to support its evaluation of the project and its costs. The nine-page document, dated June 15, 2001, and labeled a feasibility study, contained five pages of photographs and drawings of the project site and a page providing information on the physical location of the project site and background on CityVest. Although the remaining three pages were numbered, the pages were labeled "sample budget scenario" for "site considerations;" "project construction components;" and "soft costs and summaries." All three pages were marked "DRAFT" in bold letters. This nine-page document did not constitute a valid feasibility study because, as stated in its October 2002 loan application, CityVest did not know the exact future use of the Hotel Sterling. Without knowing the exact future use of the site, there were no valid, detailed project costs to be reviewed. Moreover, CityVest paid for this study. There was no evidence that the County performed an independent evaluation to assess the prospects for the project's success. It was not clear what CityVest intended to do with the loan funds.

The County's policies and procedures for its business development loan program included a single-page financial analysis checklist for evaluating loans. The County believed its evaluation procedures were sufficient. The County completed this form for the CityVest loan. However, the form did not provide sufficient evidence that the County performed a detailed evaluation of the project costs. The County marked 7 of the 10 checklist factors "N/A." It marked the other three factors affirmatively, indicating that it had obtained cashflow statements, examined the proposed costs, and tested for reasonableness of the costs. However, there was no cashflow statement in the County's files and no documentation to demonstrate that it had examined and tested the reasonableness of the costs. The only document attached to the checklist was a simple spreadsheet showing a project square footage and cost summary over two phases

⁴ Leveraging a significant amount of private investment was the first of three impacts listed in the handbook.

for the project and a list of funding sources for the first phase. The list of funding sources totaled nearly \$22.4 million, including \$13 million in private funding. However, as stated above, the exact future use of the Hotel Sterling was unknown, and the financing for this project, as disclosed in the loan agreement, did not include private funds. Therefore, the relevance of the data on the spreadsheet was dubious.

The Project Did Not Comply With HUD's Jurisdiction Requirements

The County did not have documentation in its files to demonstrate that it complied with jurisdiction requirements before or after making its loan to CityVest. The regulations at 24 CFR 570.309 state that Block Grant funds may assist an activity outside the jurisdiction of the grantee only if the grantee determines that such an activity is necessary to further the purposes of the Housing and Community Development Act of 1974 and the recipient's community development objectives and that reasonable benefits from the activity will accrue to residents within the jurisdiction of the grantee. The regulations also require the grantee to document the basis for such determination before providing Block Grant funds for the activity. In this case, the County was the grantee, and the City of Wilkes-Barre (also an entitlement grantee like the County) was the recipient because the Hotel Sterling is located in Wilkes-Barre.

The County Did Not Properly Monitor the Project

The County had no documentation in its loan files to demonstrate that it properly monitored the project. The County's monitoring procedures were weak. They focused solely on job creation. They did not include procedures for monitoring a project's progress toward completion of its objective and its compliance with HUD's and other applicable requirements. The County believed its monitoring procedures were sufficient. Regulations at 24 CFR 85.40(a) state that grantees are responsible for managing the day-to-day operations of grant- and subgrant-supported activities. Grantees must monitor grant- and subgrant-supported activities to ensure compliance with applicable Federal requirements and that performance goals are achieved.

On September 6, 2006, CityVest requested an additional \$2 million loan to supplement the \$4 million it had already received from the County for the project. On September 21, 2006, the County's board of commissioners granted preliminary approval to increase the amount of the loan because CityVest claimed that it needed the funds to enable it to proceed with the next redevelopment steps without delay. The project budget from the amended loan agreement showed that

\$200,000 was budgeted for land or building acquisition (see appendix E), which was no increase from the original budget included in the original loan agreement, and \$500,000 was budgeted for professional and financial fees (see appendix E), which was an increase of \$400,000 from the budget included in the original loan agreement. However, as of September 2006, CityVest had spent \$525,000, more than two and a half times the budgeted amount, on land or building acquisition and \$938,287, nearly twice as much the budgeted amount, on professional and financial fees (see appendix F). Moreover, although the project budget showed that \$4 million was budgeted for construction, which was an increase of \$1.5 million from the budget included in the original loan agreement, CityVest spent only \$67,739 on construction costs. CityVest spent \$3.2 million on demolition costs. Classifying these costs as construction costs rather than demolition costs, which is what they were, was misleading. The County should have reported the actual expense amounts to the board of commissioners and other involved parties. The County had the ability to provide this information because it drew down Block Grant funds and released them to CityVest based upon the presentation of receipts by CityVest for approved expenditures. The regulations at 24 CFR 570.209(c) state that if, after the grantee enters into a contract to provide assistance to a project, the scope or financial elements of the project change to the extent that a significant contract amendment is appropriate, the project should be reevaluated under the guidelines of 24 CFR 570.209 and the recipient's guidelines. Without complete and accurate expenditure data, decision makers and other involved parties lacked significant information on which to evaluate the future of the project.

The County Did Not Ensure That Required Audits Were Performed

The County did not ensure that CityVest complied with the audit requirements of Office of Management and Budget (OMB) Circular A-133⁵ and its loan agreement. OMB Circular A-133 requires non-Federal entities that expend \$500,000 or more in Federal funds in any given fiscal year⁶ to have an independent audit conducted that complies with the requirements of the circular.⁷ The loan agreement and amended loan agreement reiterated these requirements.

⁵ Audits of States, Local Governments, and Non-Profit Organizations

⁶ The threshold amount for conducting an audit was increased from \$300,000 to \$500,000 for fiscal years ending after December 31, 2003.

⁷ If Federal funds expended in any fiscal year total \$500,000 or more and funding is from more than one Federal program, a single audit must be conducted. If Federal funds expended in any fiscal year total \$500,000 or more and are from only one Federal program, the recipient has the option to have a program-specific audit conducted. A single audit means an audit that includes both the entity's financial statements and the Federal awards. A program-specific audit means an audit of one Federal program. Generally, non-Federal entities that expend less than \$500,000 per year in Federal awards are exempt from Federal audit requirements for that year.

However, the County had no copies of these required audits in its files, although at least three audits should have been completed. The County stated that CityVest's fiscal year was September 1 to August 31. The table below shows the expenditure of loan funds by CityVest's fiscal year.

CityVest fiscal year	Total loan expenditures	OMB dollar threshold for audit
2003	\$284,657	\$300,000
2004	\$130,717	\$500,000
2005	\$311,027	\$500,000
2006	\$915,054	\$500,000
2007	\$3,690,122	\$500,000
2008	\$668,317	\$500,000
Total	\$5,999,894	

In addition, the loan agreements required CityVest to have program audits conducted in any fiscal year in which it expended Federal funds of less than \$500,000. The agreements required the audits to be conducted annually and submitted to the Luzerne County Office of Community Development. Therefore, CityVest was required to conduct audits annually. However, the County had no copies of any of these required audits in its files.

CityVest Incurred an Unreasonable and Unnecessary Expense

CityVest incurred an unreasonable and unnecessary expense when it expended \$303,000 in loan funds to satisfy municipal liens on a property that it purchased, which was adjacent to the Hotel Sterling. The City of Wilkes-Barre filed the municipal liens on June 20, 2005, against the former property owner for demolition work. CityVest acquired the property on March 20, 2006. On December 1, 2006, the City billed CityVest \$303,000 to satisfy the liens. On March 12, 2007, the County drew down \$303,000 in Block Grant funds to pay the liens. However, payment of the liens was the responsibility of the former property owner. If CityVest had paid off the liens at the time of settlement, the \$303,000 should have been deducted from the sale price of the property, which is customary, but in this case, it was not because the liens were not recorded on the settlement sheet.

Regulations at 2 CFR Part 225, appendix A(C)(1)(a) and (i), state that costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards and be the net of all applicable credits. Regulations at 2 CFR Part 225, appendix A(C)(2), state that a cost is reasonable if in its nature and amount, it does not exceed that which would be incurred by a

prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally funded. In determining reasonableness of a given cost, consideration should be given to whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.

The Project Had Not Met Its Designated National Objective

CityVest has spent \$6 million in Block Grant funds on the Hotel Sterling project. Ultimately, the loan agreement required CityVest to create 175 permanent full-time-equivalent jobs, with 90 of those jobs benefiting low- and moderate-income persons. All Block Grant-assisted activities are required to meet the program's eligibility criteria found in 24 CFR 570.200 to 570.206 and one of the three national program objectives described in 24 CFR 570.208.⁸ The regulations at 24 CFR 570.506(b) require the County to maintain records demonstrating that each activity meets the Block Grant program's national objective requirements. For this project, the national objective to be achieved was benefit to low- and moderate-income persons through job creation or retention activities. However, as of August 2012, the project was not complete, and no jobs had been created. The following pictures show the condition of the hotel.

⁸ Block Grant-assisted activities must meet one of the three national program objectives: (1) benefit low- and moderate-income persons, (2) prevent or eliminate slums or blight, and (3) meet community development needs having a particular urgency.



Front and side view of the hotel, May 25, 2011



Front view of the hotel, May 25, 2011

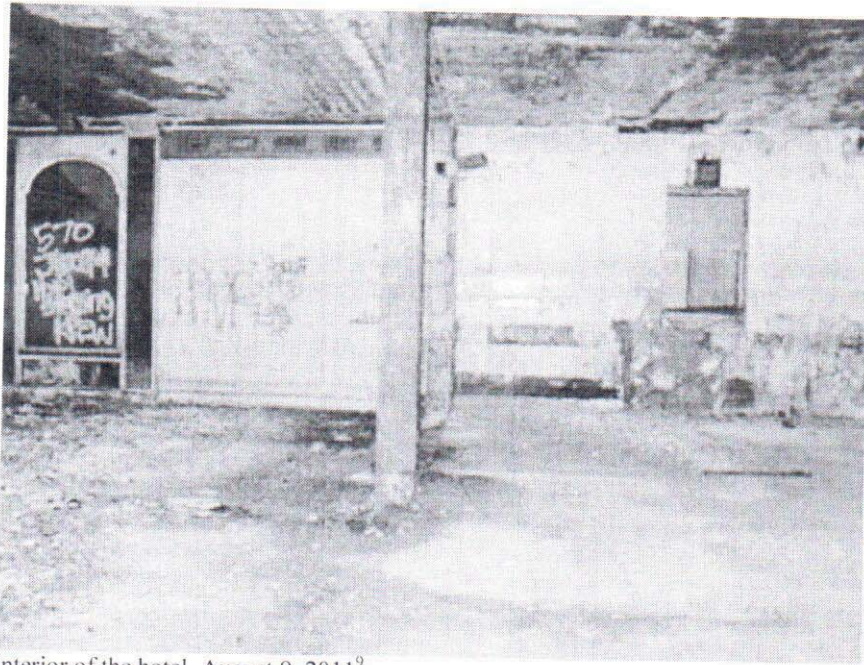


Rear view of the hotel, May 25, 2011



Roof of the hotel, August 11, 2011⁹

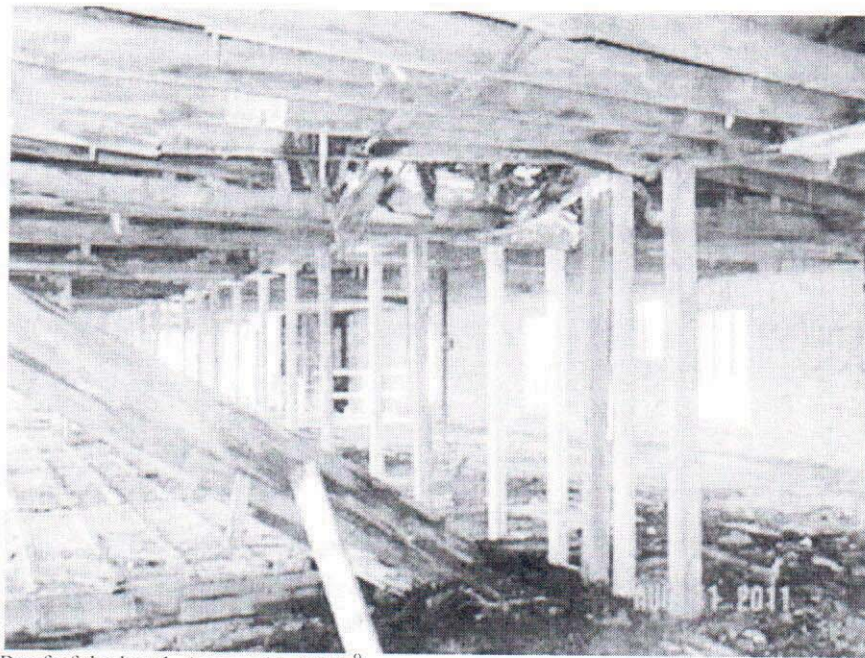
⁹ Photographs from the November 18, 2011, edition of the Citizen's Voice



Interior of the hotel, August 9, 2011⁹



Interior of the hotel, August 9, 2011⁹



Roof of the hotel, August 11, 2011⁹

The Project Will Not Meet Its Designated National Objective

The project will not meet its designated national objective because the City of Wilkes-Barre declared the structure unsafe and now the City and the County plan to demolish the hotel. The City solicited requests for proposals for demolition and the demolition will cost about \$500,000. The City requested that the County split the demolition cost with it. As a result, nearly 10 years would have passed since the County entered into its initial loan agreement with CityVest, and \$6 million in Block Grant funds would have been spent on a deteriorated hotel and a project that won't meet its national program objective.

HUD Questioned the Eligibility of the Project Based on Its Failure To Meet a National Objective

From September 9 to October 19, 2011, HUD's Philadelphia Office of Community Planning and Development conducted a remote monitoring review of the County's open and canceled Block Grant projects. This effort was also a result of HUD Office of Inspector General (OIG) audit report 2012-PH-0001. HUD determined that the CityVest project did not meet its national objective

criteria and questioned whether the project would meet it in the future. Later, the Philadelphia office appealed to the HUD headquarters Office of Block Grant Assistance to determine whether this activity should be canceled from the County's Block Grant inventory and whether it should apply sanctions against the County. As of the date of this audit report, HUD headquarters had not made a decision regarding this project.

Conclusion

The County did not properly evaluate and underwrite its loan to CityVest. The project won't meet its designated job creation national objective. The County lacked procedures to properly evaluate and underwrite its loan to CityVest and did not properly monitor the project. As a result, the County disbursed \$6 million in Block Grant funds for a project that failed to achieve its job creation national objective. Therefore, the \$6 million expended for this project was ineligible. To correct this situation, the County needs to reimburse its loan program \$6 million and develop and implement comprehensive procedures for (1) evaluating and underwriting proposed projects before approving applications for business development loans, and (2) monitoring Block Grant-assisted activities.

Recommendations

We recommend that the Director of HUD's Philadelphia Office of Community Planning and Development direct the County to

- 1A. Reimburse its business development loan program \$5,999,894 from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project.
- 1B. Develop and implement comprehensive procedures for evaluating and underwriting proposed projects before approving applications for business development loans.
- 1C. Develop and implement comprehensive procedures for effectively monitoring Block Grant-assisted activities.

SCOPE AND METHODOLOGY

We conducted the audit from March through June 2012 at the County's office located at 54 West Union Street, Wilkes-Barre, PA, and at our office located in Philadelphia, PA. The audit covered the period January 2010 through February 2012 but was expanded when necessary to include other periods. We did not rely on any computer-processed data during the audit.

To achieve our audit objective, we

- Obtained relevant background information.
- Reviewed HUD regulations at 24 CFR Part 570 regarding the Community Development Block Grant program and other applicable HUD regulations and guidance.
- Reviewed minutes from meetings of the County's board of commissioners and CityVest's board of directors.
- Reviewed the County's policies and procedures as outlined in its Business Development Loan Program Handbook related to loan applications, loan approvals, monitoring and evaluation, and closing.
- Interviewed relevant County staff and officials from HUD's Philadelphia Office of Community Planning and Development.
- Reviewed the County's business development loan portfolio.
- Reviewed CityVest's loan application and loan agreements.
- Reviewed loan fund draws totaling \$6 million and the documentation supporting those expenditures.
- Reviewed the June 15, 2001, feasibility study for the project and other correspondence and documentation maintained in the County's files for the CityVest loan.
- Observed and photographed the physical condition of the Sterling Hotel.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Policies and procedures that the County implemented to ensure that activities met established program objectives and requirements.
- Policies and procedures that the County implemented to ensure that resource use was consistent with applicable laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The County lacked comprehensive procedures for (1) evaluating and underwriting proposed projects before approving applications for business

development loans, and (2) effectively monitoring Block Grant-assisted activities.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS


Recommendation number	Ineligible 1/
1A	\$5,999,894

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG EvaluationAuditee Comments

<p>ROBERT C. LAWTON County Auditor</p> <p>COUNTY COUNCIL TIMOTHY E. CHADMAN LINDA D. GROSS-KRUEK, Vice-Chairman JAMES R. GREGG EDWARD A. BRYANSE ELAINA MADON-CURRY HARRY HAN RICHARD J. CLEVER RICHARD J. CLEVER STEPHEN A. GREGG STEPHEN J. GREGG BRIAN J. GREGG</p>	 COUNTY of LUZERNE PENNSYLVANIA ESTABLISHED 1786	<p>ANTHONY D. REED Executive Director</p> <p>CONTACT: antony@luzernecounty.org</p>
--	---	--

OFFICE OF COMMUNITY DEVELOPMENT
64 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2813 TDD: 570.825.1892

September 28, 2012

Mr. John P. Buck
U.S. Department of Housing and Urban Development
Office of Inspector General
Regional Inspector General for Audit
100 Penn Square East, Suite 10205
Philadelphia, PA 19107

RE: Draft Audit Response

Dear Mr. Buck:

I am writing to respond to the Draft Audit of Luzerne County's Community Development Block Grant Business Development Loan Program. I would however, first like to thank you for the professionalism displayed by Greg Burgwald in working with my office on the difficult task of auditing this very successful program.

It is important to note that Luzerne County's Business Development Loan Program (BDLP), which started in 1982, has a portfolio valued at \$48.5 million. Since its inception, the Program has funded 669 loans totaling \$235,690,576, with a CDBG investment of \$76.3 million, the last of which was drawn from Treasury in 2009. **These loans created 16,613 jobs, of which 12,921 are low/mod (78%), and 5,343 jobs were retained.** The cost per job is \$14,187.12. These facts were included in our June 19th letter to Mr. Burgwald as well as, Ms. Jane Vincent and Mr. Nadav Bynum of the Regional Office on June 28th and Mr. Burgwald on July 3rd. We were expecting that our complete response would be incorporated in the "Draft" Audit, but they were not.

First we would like to comment regarding the purposes of the Audit as follows:

What RIGA audited and Why—the then newly elected County Controller filed a complaint with HUD alleging misappropriation of funds as well as your personal review of certain dated files.

Luzerne County Comment

Misappropriate means that the funds were turned to a wrong purpose. This is an important point in view of the Controller's audit which showed no funds missing. Perhaps, the word "misappropriate" should be changed to a more appropriate description of what is alleged to have occurred. Furthermore while much information can be gathered from IDIS data, the IDIS system is not regulated therefore the information drawn from that source is not an official record of HUD.

What RIGA Found—The finding claims Luzerne County did not PROPERLY (emphasis added) evaluate and underwrite the \$6 Million loan to City Vest and the project did not meet its job creation goal.

Luzerne County Comment

a) The word "properly" does not appear in any HUD regulation.

Comment 6

- b) Although OIG claims 24 CFR 570.209(a) is applicable notwithstanding language that states HUD's suggested Guidelines "are not mandatory" and that "use" of HUD's Guidelines or a local standard by Luzerne County is required "to conduct basic underwriting prior to the provision of CDBG financial assistance to a FOR-PROFIT BUSINESS (emphasis added)." City Vest is a not-for-profit entity. Thus, there is no HUD requirement at 570.209(a) applicable to City Vest; however, a thorough evaluation was done.

Comment 7**Comment 8****Comment 9**

- c) Furthermore, a "basic evaluation occurred." Prior to the loan application being submitted, the County and City Vest received a feasibility study by a nationally known architect (who happens to be in Wilkes-Barre and Philadelphia) which evaluated both the structure and costs to cure. It was prepared in June, 2001, prior to the loan application (copy attached). It is a thorough evaluation. The OCD also submitted a written "evaluation" to the Commissioners prior to their approval on October 16, 2002.

What RIGA Recommended----HUD require the County to repay the Program with non-Federal funds and adopt BLDP Procedures to improve the Program Requirements.

Luzerne County Comment**Comment 10**

The County has had BLDP procedures in place for over 35 years and continues to update same to meet current needs and HUD requirements.

Comment 11

The BLDP funding for this Project and all projects undertaken since 2000 include no U.S. Treasury originated CDBG funds. Loan repayment from this Project and those in the future will continue to be funded from recycled BLDP funds therefore no repayment is required or necessary.

DRAFT AUDIT FINDING:**THE COUNTY DID NOT PROPERLY EVALUATE, UNDERWRITE, AND MONITOR A HIGH RISK LOAN****Comment 12****Comment 13**

1. RIGA claims the County only conducted a cursory level of underwriting.
2. RIGA claims the County lacked a Plan for the Sterling.
3. RIGA claims the County and City Vest should have had other funds in place to share the financial burden.
4. RIGA claims the County did not Properly Assess Project Feasibility and Evaluate Cost of the Project.
5. RIGA claims the Project did not comply with HUD's Jurisdiction Requirements.
6. RIGA claims the County did not properly monitor the Project.
7. RIGA claims the County did not ensure that required audits were performed.
8. RIGA claims City Vest incurred an unreasonable and unnecessary expense.
9. RIGA claims the Project has not met designated National Objectives.

Luzerne County Comment**Comment 14****Comment 17****Comment 9**

1. The Sterling Project was the focus of downtown redevelopment as early as 1984. In fact, the project was the main focus on the Wilkes-Barre 1992 Downtown Development Plan. For these reasons, City Vest, a non-profit Developer of last resort (not a Subrecipient) embarked on the process to save this historic property. With overwhelming support from the community, the County authorized assistance to City Vest in order to undertake this important economic development project and potential job creator of benefit to both the City and County. The actual County benefit determination occurred on October 16, 2002 when the Project was presented to the then County Commissioners by the previous Director of the Office of Community Development.

Comment 14

Comment 15

Comment 14

Comment 16

Comment 14

Comment 9

Comment 17

Comment 14

Comment 18

Comment 19

Comment 14

Comment 20

Comment 14

Comment 21

Comment 22

Comment 16

Comment 21

Comment 11

2. As stated previously, actual restoration and financial planning began in earnest in 1984 and continued until 2010. Throughout the process the historic preservation of the Sterling was part of the effort since the property was and remains on the National Register of Historic Places. The new proposed development on a cleared site will go a long way toward the original employment target for County residents. The site and new development will carry a symbol of the historic nature of the property.
3. There is no program, Federal, State, or local that can equal the flexibility that CDBG local funding can provide. It is the only such program available to places like Luzerne County or Wilkes-Barre that have the remotest chance of preserving the local communities in our Country. Usually if a HUD supported program similar to CDBG is undertaken it is successful. Even the Sterling Project will be successful when a new developer begins their development and the accompanying jobs are created for County L/M citizens and eventually the property will be back on the tax rolls.
4. The Sterling Hotel Historic Preservation and Economic Revitalization Project has been fully supported by County and City Officials, as well as the Private sector for almost 30 years. Thousands public-private volunteer hours have been expended on this most important undertaking, not only to save the structure but to use it as revenue producing facility that the citizens of Luzerne County will treasure. Although the original plans have been amended, the County expects a new developer will be able to carry on the work already begun for the site and create the new jobs aimed at supporting the original goals and revitalize Wilkes-Barre, the County Seat of Luzerne County.
5. On 10/16/02, the former OCD Director appeared before the Luzerne County Commissioners to explain the County employment, economic, tax revenue, and historic preservation benefits from the Sterling revitalization project. The Staff evaluation and determination was made on 10/2/02. Both documents are attached.
6. The County and the HUD Regional CPD Office monitored the Sterling Project on numerous occasions over the past 10 years. This Project was undertaken by a non-profit developer and not a subrecipient. Every dollar that has been expended for this Project has been reviewed and monitored by County Staff. The County's Monitoring Plan is reviewed annually and revisions are made as appropriate. Please note, City Vest is a non-profit developer and responsible for all phases of the work. The construction objectives of this development are carried out by the developer not the County OCD.
7. City Vest is a non profit developer not a subrecipient, therefore they are not guided by 24 CFR Part 84. The County does however, review each City Vest invoice in detail and have the payments approved by the County Council and Manager (previously by the County Commissioners). The County Single Audit that covered City Vest was available but not requested during the review.
8. City Vest did what was necessary to gain clear title to the Sterling. Every dollar spent by City Vest as a non-profit developer was reasonable and necessary to carry out the Project. Over such a long period of time (almost 30 years) liens mounted and many unexpected issues surfaced. City Vest never wasted any funds awarded by the County for the project. There were many roadblocks that surfaced and were dealt with by City Vest to achieve the near impossible tasks that went with this development. It was finally determined that to complete the Project, considering public safety and even more cost together with dangerous conditions that could be harmful to the general public as well as the builders that the Project was terminated and the Sterling will be demolished. The County is fortunate in the final analysis, to restart the Project and ultimately succeed in redeveloping the site to create the jobs for County citizens.
9. The Sterling Project actually qualifies under two different but compatible eligible activities. First, the Project is on the National Register of Historic Places and no matter what else happens the requirement to carry out that recognition and responsibility will be obtained by eliminating slum and blight. Alternately the County expects the project will create low and moderate income jobs per the original intent of the loan.

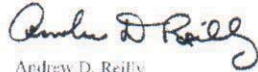
The County believes that the recycled economic funds already invested in the project will ultimately lead a redeveloped site that will stimulate the downtown development process, generate tax revenue, and ultimately lead to increased economic opportunities for low and moderate income residents of the County. Due to the nature of the situation to impose a financial sanction would be counterproductive especially in light of the fact that BLDP funds

Comment 23

have been recycled many times and have no clear relationship to current U.S. Treasury funds. The CDBG regulations allow for other than financial sanctions if guidance is required to be imposed.

Please do not hesitate contact me if you have any questions regarding this response.

Sincerely,



Andrew D. Reilly

Attachment(s)

cc: Jane C. W. Vincent
Nadab O. Bynum
Heana Colon
Dave Kasperowicz
Greg Burgwald

OCD will recommend the following to the Board of Commissioners at the meeting of 10/16/02:

\$4,000,000 BDLP Loan to assist in financing acquisition and restoration costs related to the development of the Hotel Sterling projected.

Funds to be disbursed over a 3 year period

\$2,000,000 available 2002

\$1,000,000 available 2003 and 2004

Loan Terms: 20 years, 0%, with first \$1,000,000 forgiven at 20% a year for 5 years

Initial funding release will consist of \$200,000 toward the purchase price at the Sheriff sale

Upon acquisition, County and CityVest will immediately address stabilization requirements outlined by the PA Historical & Museum Commission to insure no further damage to the structures during the design and assessment stages of the project

Balance of OCD funding will be utilized for eligible economic development activities, as costs are incurred

City Vest and the County will work very closely on the development and design process, and efforts to obtain additional financial backing for the project

BDLP funding is vital for these initial stages to enable CityVest to bring the property to a stabilized level that will ultimately generate interests by development teams

The project will ultimately lead to increased economic opportunities for County residents through the development of downtown office and retail space that will create jobs; the project will stimulate the downtown development process; generate tax revenue; and return a historically significant building that has played a significant role in the area's history to active reuse.

LUZERNE COUNTY COMMISSIONERS
THOMAS P. PIZANO, CHAIRMAN
THOMAS A. MAKOWSKI, ESQ.
STEPHEN A. URBAN

JAMES M. TORBIK, Chief Clerk



SANDRA J. RUSSELL
Director

JAMES P. BLAUM, ESQ.
County Solicitor

LUZERNE COUNTY
OFFICE OF COMMUNITY DEVELOPMENT
54 West Union Street, Wilkes-Barre, PA. 18711

E-Mail:
luzcoocdd@epix.net

(570) 824-7214
FAX (570) 829-2910
TDD (570) 825-1880

TO: File

RE: Staff Determination of Need for BDLP Assistance
Recipient: CityVest
Loan Amount: \$4,000,000
Term: To Be Negotiated
Loan Number: BDS-02-J02-D
Rate: To Be Negotiated

In determining whether assistance to the aforementioned Recipient is necessary and/or appropriate, consideration has been given to the statement of need, public benefit, job creation and retention, summary project costs, and financial documents provided by the Recipient in the BDLP Application.

Upon analysis of the aforementioned information, it has been determined that the BDLP loan amount requested is necessary for carrying out the activities by the Recipient, as described in the BDLP Application.

COMMENTS:

Needs of Business: Non-profit community development corporation with a mission to undertake development projects to enhance the economic revitalization of the downtown urban centers of Wyoming Valley has endeavored to restore the former Hotel Sterling building, which has become a blighting influence in downtown Wilkes-Barre due to neglect and bankruptcy on behalf of the ownership. If successful, this major endeavor is seen as a possible catalyst to the downtown revitalization effort in this city. This corporation has assembled a variety of skilled business professionals to guide and promote its projects; however a major stumbling block at this time is the lack of adequate funds to encounter a project of this magnitude. The proposed developer has injected its available equity and will seek in excess of \$3,000,000 from various Federal and State sources, to account for 50% of the funding needed to acquire and restore the property to make it marketable for commercial development. The BDLP funds provide the necessary gap funding to make this endeavor possible, since conventional financing is not practicable due to the nature of this project.

BDL-8

SEP 28 2012 09:34AM PM

FILE NO. 2009040204

FROM :

Public Benefit: Initially, this project will have a positive impact by taking an extremely blighted and otherwise useless property and returning it to a functional use, thereby increasing the real estate tax base for the community. During the restoration phase of the project, at least 50 temporary construction jobs can be expected to be available. Ultimately, it is anticipated that 150 new, full-time equivalent, permanent employment positions will be created, with at least 50 expected to be made available to persons from low/moderate income backgrounds. Therefore, the local wage tax base will also be strengthened because of this endeavor.

Financial Analysis: The proposed developer's most recent fiscal year financial statement indicates that the debt to equity position of the corporation is about 2 to 1; however a further review of the financial data indicates that \$285,000 of funds has been reported as deferred revenue, which accounts for grants that have been received, but for which no expenses have been incurred, thus the aforementioned ratio would become .76 to 1, which shows that the corporation has some equity to work with. The combination of funding from Federal and State sources, along with the BDLP intention which is proposed will allow this developer to restore this major real estate located in a prominent downtown location to a condition where it will be attractive for prime commercial development, at which point CityWest will be in a position to maintain an ownership factor which will allow for the debt service obligations to be met.

Most small businesses fail within their first years of operation because they are undercapitalized and lack proper management skills. According to Dunn and Bradstreet, "The cash operating cycle, or the time it takes after an investment of funds in products or services to receive cash from customers, is significant. The dimensions can be managed by controlling the level of cash to be invested in inventories and receivables." For example:

A business startup/expansion is faced with maximum expenditures and minimum returns during the first year of operation. The BDLP was developed to offset the uneven balance (cash flow) that can affect the performance of the business. A business requires working capital in the early stages of growth and OCD takes into account that the availability of equity will be needed by the business to help service daily operations and to meet any unforeseen expenses. With an adequate cash level, the business risk of having to incur additional short-term debt is reduced. The BDLP loan helps the business to be in a more sensitive situation at the end of the loan term. It is a one-year guaranteed "bridge loan" designed to provide a business with a reasonable and adequate rate of return and recognizing at the same time that many factors can affect the business projections, both positively and adversely. This is how OCD balances the guaranteed maximum returns to us with the economic health of the project.

ATE: 10/4/02

Joseph M. Dwyer
Loan Counselor
(BDLP)

CD - UNCLASSIFIED 02/07/1999

REPRODUCTION: 10/1/04

10/1/04

OIG Evaluation of Auditee Comments

- Comment 1** The County's statements are unsupported. We did not audit the County's program from its inception.
- Comment 2** As part of our normal process, we included the auditee's complete written response to the draft report as an appendix in the final audit report.
- Comment 3** The audit report reflects the language from the complaint. The complaint alleged possible misappropriation of funds. The Inspector General Act of 1978 gave HUD OIG the authority to initiate, carry out and complete independent and objective audits of HUD programs and operations. We initiate audits based on information obtained from program officials, program research, complaints, congressional requests and risk assessments. These audits include performance audits, which determine whether programs are achieving the desired results or benefits in an efficient and effective manner.
- Comment 4** The Integrated Disbursement and Information System (IDIS) is the drawdown and reporting system for all of HUD's Office of Community Planning and Development (CPD) formula grant programs including the Block Grant program. The other CPD formula grant programs covered by the System are the HOME Investment Partnerships program, Emergency Shelter Grant, and Housing Opportunities for Persons with AIDS. Grantees also use the System for tracking American Recovery and Reinvestment Act of 2009 CPD programs. As a nationwide database, the System is intended to provide HUD with current information regarding CPD activities underway across the Nation, including funding data. The System is used by HUD in managing the activities of more than 1,200 HUD grantees, including urban counties and States, which use the System to plan projects and activities, draw down program funds, and report on accomplishments. HUD also uses the System to generate reports used within and outside HUD, including the public, participating jurisdictions, and Congress. Grantees are able to update, change, cancel, reopen, and increase or decrease project funding in the System without review by HUD.
- Comment 5** The County's statement is unsupported. The word "properly" does in fact appear in regulations applicable to the County's program, for example, in the regulations at 24 CFR 570.509 and 2 CFR Part 225. However, we used the words "did not properly" in the audit report to summarize and characterize our overall conclusion regarding the County's lack of evaluation, underwriting, and monitoring of its \$6 million loan to CityVest.
- Comment 6** As stated in the audit report, the County was responsible for properly evaluating and underwriting its \$6 million loan to CityVest. HUD regulations at 24 CFR 570.209(a) provide the County guidelines designed to provide a framework for financially underwriting and selecting Block Grant-assisted economic

development projects that are financially viable and will make the most effective use of Block Grant funds. The objectives of the underwriting guidelines include ensuring that project costs are reasonable; all sources of project financing are committed; the project is financially feasible; and to the extent practicable, Block Grant funds are disbursed on a pro rata basis with other finances provided to the project. However, the County's policies and procedures for evaluating and underwriting its Block Grant loans consisted solely of a single-page checklist that failed to adequately cover key HUD guidelines. HUD's underwriting guidelines recognized that different levels of review may be appropriate to take into account the size and scope of a proposed project. Although the HUD guidelines for evaluating project costs and financial requirements are not mandatory, HUD expects recipients to properly evaluate and underwrite these loans. HUD expects recipients, when they develop their own programs and underwriting criteria, to take these factors into account. Given that the \$6 million loan the County made to CityVest was by far the largest loan in its business development loan portfolio, it was reasonable to expect the County to have conducted more than a cursory level of evaluation and underwriting before making the loan.

Comment 7 We disagree with the County's assertion that a thorough evaluation was done. As stated in the audit report, the County approved the loan although the project lacked a plan; the County did not ensure that other project funds were committed to the project; the County did not properly assess the feasibility of the project and evaluate the project's costs; the project did not comply with HUD's jurisdiction requirements; the County did not properly monitor the project; and the County did not ensure that required audits were performed.

Comment 8 Contrary to the County's assertion, it did not include a copy of the June 2001 study with its written response to the audit report. As stated in the audit report, the County alleged that a feasibility study for the project was performed in 2001 to support its evaluation of the project and its costs. The nine-page document, dated June 15, 2001, and labeled a feasibility study, contained five pages of photographs and drawings of the project site and a page providing information on the physical location of the project site and background on CityVest. Although the remaining three pages were numbered, the pages were labeled "sample budget scenario" for "site considerations;" "project construction components;" and "soft costs and summaries." All three pages were marked "DRAFT" in bold letters. This nine-page document did not constitute a valid feasibility study because, as stated in its October 2002 loan application, CityVest did not know the exact future use of the Hotel Sterling. Without knowing the exact future use of the site, there were no valid, detailed project costs to be reviewed. Moreover, CityVest paid for this study. There was no evidence that the County performed an independent evaluation to assess the prospects for the project's success. It was not clear what CityVest intended to do with the loan funds.

- Comment 9** The Office of Community Development's written "evaluation" to the commissioners prior to their approval of CityVest's loan application on October 16, 2002, stated that it was based upon information contained in CityVest's loan application. As stated in the audit report, we found no evidence that the County performed an independent evaluation to assess the prospects for the project's success.
- Comment 10** In light of the County's statement, we expect that it will be receptive to our recommendations and implement corrective actions to meet the intent of those recommendations.
- Comment 11** The County provided no documentation to support its statements. Since the County's business development loan program was originated with Block Grant funding the subsequent repayment of loaned funds and the interest earned on the loaned funds are considered Block Grant funds.
- Comment 12** The audit report stated that the County approved a loan for a project that lacked a plan.
- Comment 13** The audit report stated the County did not ensure that other project funds were committed to the project.
- Comment 14** The County provided no documentation to support these statements.
- Comment 15** Susquehanna Real Estate LP issued a study dated March 31, 2011, that offered options for redevelopment of the Hotel Sterling site. It stated that after a comprehensive gathering and analysis of studies, information, and plans as well as a physical review and inspection of the building, the Susquehanna team concluded that there were three possible alternative development strategies. Each was detailed and analyzed in the context of financial costs and feasibility, historic and public perspective, practicality, legal and liability issues, as well as the implementation factor - a scoring that reflects the likelihood of being able to overcome challenges in order to actually get a project going. In addition, there were critical building factors present that weighed on each alternative. Because of a rapidly deteriorating building condition, time and inertia were working against the interests of those seeking to initiate a successful redevelopment strategy. Having been open to the elements for an extended period, and with the resulting water infiltration, the building had suffered sufficient degradation to the point where a series of events such as major snow load, high wind storm, or movement of the make-shift support bracing could result in a catastrophic failure of the building or integrity of the exterior facade. Because of all of these factors, there was urgency in coming to a decision on how to move forward. Although numerous possibilities and combinations were potentially available for discussion and review, the team reduced these down to the three basic options detailed as follows:

1. Preservation and restoration of the existing building
2. Partial demolition with retention of the 1st and 2nd levels
3. Complete demolition and site preparation

Susquehanna stated that each of these options was considered in the context of likely uses appropriate for the building and site based on the findings of the team's marketing research. Susquehanna concluded that the full demolition option represented the most rational and economic approach while preserving the opportunity to develop the site when market conditions will allow it to achieve its highest and best use. The costs of this approach to resolve the immediate issues facing the building are in the range of \$1 to \$2 million allowing for some site enhancement until a new major development can be implemented. The City solicited requests for proposals for demolition and the County commissioners voted on September 25, 2012, to demolish the hotel. The estimated cost of the demolition was \$492,729.

Comment 16 The County's statement is unsupported. The success of the new developer, the accompanying jobs to be created, and tax revenue to be generated remain to be seen. The County believed that the first developer (CityVest) would be successful revitalizing the Hotel Sterling site and after 10 years since first agreeing to loan it funds, \$6 million has been spent on a project that failed to achieve its job creation national objective resulting in a deteriorated hotel that the City and County now plan to demolish.

Comment 17 Contrary to the County's assertion, CityVest was a subrecipient. The regulations at 24 CFR 570.500(c) define a subrecipient as a public or private nonprofit agency, authority, or organization, or authorized for-profit entity receiving Block Grant funds from the recipient or another subrecipient to undertake activities eligible for such assistance.

Comment 18 We did not make any reference to 24 CFR Part 84 in the audit report.

Comment 19 As stated in the audit report, the County did not ensure that CityVest complied with the audit requirements of Office of Management and Budget (OMB) Circular A-133 and its loan agreement. OMB Circular A-133 required non-Federal entities that expended \$500,000 or more¹⁰ of Federal funds in any given fiscal year to have an independent audit conducted that complied with the requirements of the circular. The loan agreement and amended loan agreement reiterated these requirements. However, the County had no copies of these required audits in its files although at least three audits should have been completed. We did not request a copy of the County's Single Audit because it would not address these requirements. Regardless, at the exit conference, we asked the County to provide any documentation that it believed we needed to consider to address any issues

¹⁰ See footnote 6.

presented in the draft audit report and the County provided no additional documentation.

- Comment 20** We disagree with the County's assertion. As stated in the audit report, CityVest incurred an unreasonable and unnecessary expense. On June 20, 2005, the City of Wilkes-Barre filed two municipal liens against the former owner of a property that CityVest acquired on March 20, 2006. The former property owner was responsible for paying the liens. If CityVest had paid off the liens at the time of settlement, the \$303,000 should have been deducted from the sale price of the property, which is customary, but in this case, it was not because the liens were not recorded on the settlement sheet.
- Comment 21** We disagree with the County's characterization of this situation as fortunate. In our opinion, we believe the exact opposite is true. Due to its failure to properly evaluate, underwrite, and monitor its loan to CityVest, the County allowed \$6 million to be spent on project that failed to achieve its job creation national objective resulting in a deteriorated hotel that now needs to be demolished. The ultimate success of redeveloping the site to create jobs for County residents has yet to be demonstrated.
- Comment 22** The County qualified its loan of Block Grant funds to CityVest based on an expectation that the project would create at least 80 permanent full-time-equivalent jobs benefiting low- and moderate-income persons. That has not happened nor has the expenditure of the \$6 million of Block grant funds for this project resulted in the elimination of slum and blight. Rather, the County's failure to properly evaluate, underwrite, and monitor this project has contributed to the site of the Hotel Sterling being a blight in the community over the last 10 years.
- Comment 23** As stated in the audit report, since the project failed to achieve its job creation national objective, the \$6 million expended for this project was ineligible. Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

Appendix C

PROJECT BUDGET FROM LOAN APPLICATION

** These expenses are estimated, and actual expenses will change based upon the ultimate use of the facility. A revised estimate will be provided when the costs are more ascertainable.

G. PROPOSED SOURCES AND USES OF FUNDS - PROJECT BUDGET

	Business Development Loan Funds	Developer's Equity	Other *** Source	Other Source	TOTAL
Provide Names of Other Sources					
1. Land and/or Building Acquisition	\$ 200,000.00	\$ 800,000.00	\$ 1,000,000.00	\$	\$ 2,000,000.00
2. Construction Costs to Contractor	2,500,000.00**	50,000.00	2,000,000.00		4,550,000.00
3. Professional/Financial Fees	100,000.00**		50,000.00		150,000.00
4. Machinery & Equipment	1,200,000.00**		100,000.00		1,300,000.00
5. Working Capital (Mfg. only)					
TOTAL	\$ 4,000,000.00	\$ 850,000.00	\$ 3,150,000.00	\$	\$ 8,000,000.00

H. PROPOSED PROJECT PERFORMANCE SCHEDULE

Provide breakdown of projected usage of Business Development Loan Funds indicated above for a twelve month period or other period as applicable (attach additional sheet if needed).

Indicate month and year below	Land and/or Building Acquisition	Construction Costs to Contractor	Professional Fees and/or Financial Fees	Machinery & Equipment	Working Capital	TOTAL
1. 11/02	\$ Building Acquisition, Title Insurance	\$ Property Survey *	\$	\$	\$	\$
2. 11/02 - 2/03	Structural Analysis, Environmental Analysis, Development of Stabilization/Mothball Program *					
3. 2/03-6/03	Property Stabilization/Mothball Program *					
4. 11/02-	Prepared Development Plan and Request for Qualifications from Developers *					
5. 6/03-	Redevelopment of Property *					
6.						
7.						
8.						
9.	*Note - These dates are based upon reasonable estimates and may change once the intended use of the facility is better determined. A revised schedule will be provided at a later date.					
10.						
11.						
12.						
TOTAL:	\$	\$	\$	\$	\$	\$

***CityWest intends to seek funding from the U.S. Department of Commerce, Economic Development Administration, the U.S. Housing and Urban Development Agency, the Environmental Fund Program, the Pennsylvania Department of Community and Economic Development, and other federal and state funding sources. CityWest has not received approval for any of this funding yet.

Appendix D

PROJECT BUDGET FROM LOAN AGREEMENT

EXHIBIT D
PROJECT BUDGET - SUMMARY OF PROPOSED EXPENDITURESA. Eligible BDLP Activity
B. Other Activities Costs

SOURCES OF PERMANENT FINANCING

	BDLP FUNDS	Developer's Equity	Other Funds	TOTAL
A 1. Land and/or building acquisition	\$ 200,000	\$ 800,000	1),2),3),4),5) \$1,000,000	\$2,000,000
A 2. Construction cost to Contractor	\$2,500,000	\$ 50,000	1),2),3),4),5) \$2,000,000	\$4,550,000
A 3. Professional/Financial Fees	\$ 100,000		1),2),3),4),5) \$ 50,000	\$ 150,000
A 4. Machinery/Equipment	\$1,200,000		1),2),3),4),5) \$ 100,000	\$3,300,000
A 5. Working Capital				
TOTAL PROJECT COSTS (summary of lines A-1 to B-4)	\$4,000,000	\$ 850,000	\$3,150,000	\$8,000,000

NOTES: * 1) U.S. Department of Housing & Urban Development

* 2) U.S. Department of Commerce

* 3) U.S. Economic Development Administration

* 4) U.S. Environmental Protection Agency

* 5) PA Department of Community & Economic Development

* And/or other funding entities. Prior to release of funding for each phase of the Project, Recipient shall demonstrate evidence of non-BDLP funds needed to insure completion of that particular phase of the Project

EXHIBIT D

PAGE 1 OF 1

Appendix E

PROJECT BUDGET FROM AMENDED LOAN AGREEMENT

Recipient: CityVest

Loan Number: BDS-02-J02-R

AMENDMENT TO EXHIBIT D

PROJECT BUDGET - SUMMARY OF PROPOSED EXPENDITURES

EXHIBIT D

Eligible BDLP Activity	SOURCES OF NON-COUNTY FINANCING			
	BDLP FUNDS	DEVELOPER'S EQUITY	OTHER FUNDS	TOTAL
A.1. Land and/or Building Acquisition	\$ 200,000	\$ 800,000	1,2,3,4,5 \$1,000,000	\$2,000,000
A.2. Construction Cost to Contractor	\$4,000,000	\$ 50,000	1,2,3,4,5 \$2,000,000	\$6,050,000
A.3. Professional/ Financial Fees	\$ 500,000		1,2,3,4,5 \$ 50,000	\$ 550,000
A.4. Machinery/ Equipment	\$1,300,000		1,2,3,4,5 \$ 100,000	\$3,400,000
A.5. Working Capital				
TOTAL PROJECTS COSTS	\$6,000,000	\$ 850,000	\$3,150,000	\$10,000,000

(Summary of lines A-1 to A-5)

NOTES: 1) US Department of Housing & Urban Development
 2) US Department of Commerce
 3) US Economic Development Administration
 4) US Environmental Protection Agency
 5) PA Department of Community & Economic Development

Eligibility:

CR
 SED ☒
 PI

Loan Counselor:

Appendix F

CITYVEST EXPENDITURE SUMMARY**Total expenditures**

Description	Amount	Percentage
Demolition	\$3,213,714	53.6%
Acquisitions	\$1,497,144	25.0%
Real estate advisor fees	\$688,540	11.5%
Engineering fees	\$302,645	5.0%
Attorney fees	\$124,180	2.1%
Insurance fees	\$92,281	1.5%
Construction	\$67,739	1.1%
Miscellaneous fees	\$13,651	0.2%
Total	\$5,999,894	100%

Expenditures as of August 31, 2006, by project budget

Project budget cost description	Amount expended	Project budget – loan agreement
A1. Land or building acquisition	\$525,000	\$200,000
A2. Construction cost to contractor	\$178,168	\$2,500,000
A3. Professional and financial fees	\$938,287	\$100,000
A4. Machinery and equipment	\$0	\$1,200,000
Total	\$1,641,455	\$4,000,000

Total expenditures compared to loan agreement project budgets

Project budget cost description	Amount expended	Project budget - loan agreement	Project budget - amended loan agreement
A1. Land or building acquisition	\$1,497,144	\$200,000	\$200,000
A2. Construction cost to contractor	\$3,281,453	\$2,500,000	\$4,000,000
A3. Professional and financial fees	\$1,221,297	\$100,000	\$500,000
A4. Machinery and equipment	\$0	\$1,200,000	\$1,300,000
Total	\$5,999,894	\$4,000,000	\$6,000,000

ROBERT C. LAWTON
County Manager

ANDREW D. REILLY
Executive Director

COUNTY COUNCIL

TIM MCGINLEY, CHAIRMAN
LINDA MCCLOSKEY HOUCK, VICE CHAIRMAN
JAMES BOBECK
EDWARD A. BROMINSKI
ELAINE MADDON CURRY
HARRY HAAS
EUGENE L. KELLEHER
RICK MORELLI
STEPHEN A. URBAN
STEPHEN J. URBAN
RICK WILLIAMS



COUNTY of LUZERNE
P E N N S Y L V A N I A
ESTABLISHED 1786

E-MAIL:
luzcoocd@luzernecounty.org

OFFICE OF COMMUNITY DEVELOPMENT
54 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2910 TDD: 570.825.1860

December 7, 2012

Mr. Nadab O. Bynum, Director
Office of Community Planning and Development
U.S. Department of Housing and Urban Development
Philadelphia Office
The Wanamaker Building
100 Penn Square East
Philadelphia, PA 19107-3380

RE: Luzerne County, PA-Audit Report 2013-PH-1001

Dear Mr. Bynum:

I am writing in response to your letter dated November 26, 2012. The following is the County's Response to the above referenced audit report:

What OIG audited:

1. We audited Luzerne County's \$6 million loan of Community Development Block Grant funds to CityVest that was expected to be used to revitalize the historic Hotel Sterling and surrounding properties.

Luzerne County's Response:

The language indicates that the funds were not used to revitalize the Sterling. They were only "expected" to be used for that purpose. What were they used for? Our review of every payment shows they were 100% used for that purpose.

Why OIG Audited Luzerne County

2. We received a citizen complaint alleging possible misappropriation of these funds.

Luzerne County's Response

The OIG knows that the "citizen" was in fact, the elected County Controller acting in his official capacity. "Misappropriation" means the act of turning to a wrong purpose. However, OIG received a copy of the Controller's audit which clearly does NOT state this. Furthermore, elsewhere in this audit, OIG responds to our position on the use of this term, to the effect, "we're only repeating what the Controller said." We believe this term is inflammatory. We believe OIG has an obligation to state whether, in fact, there was "misappropriation" (which there clearly was not).

OIG Comments

3. The County did not properly evaluate, underwrite, and monitor its loan to CityVest.

Luzerne County's Response

OIG, once again, misstates and distorts the language at 24 CFR 570.209 and 24 CFR 570.502(a)(4). (See the County's several previous responses regarding evaluation/underwriting). Luzerne County has responded to this allegation at least twice. OIG ignores our response and fails to explain why. As to monitoring, 24 CFR 85.40(a) does not use the word "properly".

OIG Comments

4. CityVest also used HUD funds inappropriately to make an unreasonable and unnecessary expenditure of \$303,000 to satisfy two municipal liens against a property that it had purchased. It was the responsibility of the former property owner to satisfy the liens.

Luzerne County's Response

There were 2 acquisitions. The second involved a different parcel of land and thus, the \$303,000 was NOT a duplication or a payment in connection with the earlier acquisition.

The County had reached an agreement to purchase this added parcel but had not yet signed the Agreement of Sale. The City of Wilkes-Barre then condemned and demolished the added building and liened the property for \$303,000 (the cost of the demolition). Thus, there was no duplicate. The \$303,000 lien obligation did not previously exist.

OIG Comments

5. The County consists of 76 municipalities, governed by a three-member board of commissioners.

Luzerne County's Response

This description has not existed since January 2012 when 11 County Councilmember's replaced the 3-member board. We find it interesting that the governing body of the County is addressed in non-capital letter whereas infra "the Plan" (which is not a requirement) is solemnized in capitals.

OIG Comments

6. The loan program provides low-interest financing to firms carrying out eligible economic development type projects meeting program objectives.

Luzerne County's Response

There is NO such thing in HUD regulations as "eligible economic development type projects". That language does NOT appear anywhere. Not only that, CityVest is NOT a "firm". Firms are businesses. OIG again has misstated a regulation.

OIG Comments

7. Our objective was to determine whether the County properly evaluated and underwrote its loan to CityVest and whether the project met its designated national objective.

Luzerne County's Response

The word "properly" is subjective. It does NOT appear in 24 CFR 570.209 which are printed below.

§ 570.209 Guidelines for evaluating and selecting economic development projects.

The following guidelines are provided to assist the recipient to evaluate and select activities to be carried out for economic development purposes. Specifically, these guidelines are applicable to activities that are eligible for CDBG assistance under § 570.203. These guidelines also apply to activities carried out under the authority of § 570.204 that would otherwise be eligible under § 570.203, were it not for the involvement of a Community-Based Development Organization (CBDO). (This would include activities where a CBDO makes loans to for-profit businesses.) These guidelines are composed of two components: Guidelines for evaluating project costs and financial requirements; and standards for evaluating public benefit. The standards for evaluating public benefit are *mandatory, but the guidelines for evaluating projects costs and financial requirements are not.* (Emphasis added)

- (a) *Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.* HUD has developed guidelines that are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects, which are financially viable and will make the most effective use of the CDBG funds. These guidelines, also referred to as the underwriting guidelines, are published as appendix A to this part. *The use of the underwriting guidelines published by HUD is not mandatory. However, grantees electing not to use these guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.* (Emphasis added) Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a microenterprise or other small business to take into account the differences in the capacity and level of sophistication

Among business of differing sizes. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. The objectives of the underwriting guidelines are to ensure:

- (1) That project costs are reasonable;
- (2) That all sources of project financing are committed;
- (3) That to the extent practicable, CDBG funds are not substituted for non-Federal financial support;
- (4) That the project is financially feasible;
- (5) That to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

NOTE: This section continues but is not germane.

OIG Comments

8. The County lacked comprehensive procedures for evaluating and underwriting proposed projects before approving business development loans.

Luzerne County's Response

There is NO regulation requiring a "comprehensive procedure ...", nor a definition of those words. A clear, unambiguous reading of 24 CFR 570.209 (see above) states, "The guidelines for evaluating public benefit are mandatory, but the guidelines for evaluating project costs and financial requirements are not." THUS, there is no requirement to do what OIG claims is required. It goes on to state at subsection (a) of 570.209, "The use of underwriting guidelines published by HUD is NOT mandatory." It then continues in the next sentence, "However, grantees electing not to use these guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a FOR PROFIT business." CityVest is not a for-profit business and thus, was not required to meet this test and most importantly, OIG is incorrect in its reading of the law.

OIG Comments

9. The related funds were ineligible program expenditures.

Luzerne County's Response

There is no listing in the Audit of any ineligible program expenditure. Eligible activities are listed at 24 CFR 570.201 through .206. 24 CFR 270.207 lists ineligible activities and the expenditures for the Sterling are not mentioned. OIG does NOT cite any such ineligible activity.

OIG Comments

10. HUD regulations at 24 CFR (Code of Federal Regulations) 570.209(a) provide the County guidelines designed to provide a framework for financially underwriting and selecting Block Grant-assisted economic development projects that are financially viable and will make the most effective use of Block Grant funds.

Luzerne County's Response

See Responses 7 and 8 above. This citation is intentionally misquoted by OIG or partially misquoted to distort and support a false conclusion. There is NO requirement at 24 CFR 570.209 (a) to evaluate non-profits such as CityVest. We set forth this section in full above in Response 7.

OIG Comments

11. HUD's underwriting guidelines recognized that different levels of review may be appropriate to take into account the size and scope of a proposed project.

Luzerne County's Response

While this is true for a "for profit business", it is not applicable in this instance. Read the full language. The language talks about "businesses". Again, a misquote/misunderstanding of a fact to support a predetermined conclusion.

OIG Comments

12. HUD expects recipients to properly evaluate and underwrite these loans.

Luzerne County's Response

The language in HUD's regulations does NOT state that "HUD expects recipients to properly evaluate and underestimate these loans." On the contrary, HUD's regulations clearly exempt such loans to non-profits. It requires an evaluation ONLY for a FOR-PROFIT business. This is OIG's expectation.

OIG Comments

13. Given that the \$6 million loan the County made to CityVest...

Luzerne County's Response

This transaction in HUD terms was NOT a loan. A loan by any definition has four (4) elements: a) a principal sum; b) a placing of the sum with a safe borrower; c) an agreement that interest is to be paid; and d) a recognition by the recipient (borrower) of the money of his liability for return of the principal amount.

As to sub-items c) and d) above, interest was not to be paid; in fact, much of the principal was to be forgiven. HUD refers to such transactions as "DEFERRED GRANTS", meaning they were never intended to be repaid.

OIG Comments

14. It was reasonable to expect the County to have conducted more than a cursory level of evaluation and underwriting before making the loan.

Luzerne County's Response

OIG now admits an evaluation was done even though not required. They term it "cursory". If none is required then, cursory should be commended. An evaluation was done on June 15, 2001. A copy was submitted to OIG. OIG feels it is unresponsive to a non-existent requirement. It is again re-submitted. OIG terming it "cursory" is substituting its judgment in place of that done by the County. We are disturbed that OIG keeps repeating the same false requirement. It drives what should be one page in the Audit to several as if heft of the document gives more importance (as opposed to substance).

OIG Comments

15. CityVest stated that "the exact future usage of the Hotel Sterling is unknown. CityVest intends to seek developers to assist and/or operate the site at a later date." Despite these statements, the County entered into a \$4 million loan agreement with CityVest on November 6, 2002, or 35 days later.

Luzerne County's Response

Neither HUD nor OMB regulations require "a Plan" nor is such a term defined anywhere. OIG is obviously unfamiliar with the development processes. This is exactly how they work. Determine the market; determine the costs; attempt to market the site; use market responses to obtain financing; and undertake the project.

OIG Comments

16. The County did not ensure that all needed sources of project funding were committed at the time the loan agreement was signed.

Luzerne County's Response

There is NOT a requirement that all funds be committed prior to a loan agreement. OIG in fact quotes the transparency, which everyone in Luzerne County knew. Interestingly, OIG does not cite its source of its statement in Federal regulation. The loan agreement which is the contract between the parties does not commit to any funds. As OIG knows or should know, CityVest directly received \$1,350,000 from HUD. There is no indication in the Audit of how these funds were spent. Exhibit F does not account for them. OIG states CityVest had not applied for the \$2.2 Million. That is, because the City itself did and in the amount of \$3,000,000 was received by the City for the Sterling. OIG does not account for these funds either. A memo from OIG dated May 21, 2012 shows OIG was aware of some of these funds but does not discuss them properly or account for them. OIG never mentions the PA Gaming Grant which CityVest received.

OIG Comments

17. The County had documentation to demonstrate that CityVest received a \$1 million grant from HUD for the project at the time the loan agreement was signed. However, the grant was to be used for the Hotel Sterling project and another.

Luzerne County's Response

OIG is really criticizing HUD who prepared "The grant agreement" referenced, except OIG blames CityVest and Luzerne County. Furthermore, this was transparent. Therefore, again, criticism is misplaced. The loan agreement does not require what OIG suggests.

OIG Comments

18. Lastly, the County's Business Development Loan Program Handbook stated that the program was intended to finance projects that would have a positive impact on the County by leveraging a significant amount of private investment.¹ However, the planned financing for this project did not include private funds, although the president and chief executive officer of Guaranty Bank was a member of CityVest's board of directors.

Luzerne County's Response

OIG is critical of matters that arose long after the loan application. OIG talks elsewhere of a "Plan". The loan application anticipated other funds. Such language is a Plan (though not required, *per se*). Furthermore, CityVest did expend considerable funds to market this building which would have provided significant "private funds". Once again, OIG plays Monday morning quarterback. The Agreement between the County and CityVest does not require the County private financing, so, why is it an issue?

As to the footnote, it is only applicable to projects requiring an evaluation – namely, a for-profit business. OIG once again intentionally distorts the subject matter.

OIG Comments

19. The County alleged that a feasibility study for the project was performed in 2001 to support its evaluation of the project and its costs.

Luzerne County's Response

OIG again distorts that the feasibility study was "alleged" to be a Feasibility Study. That's what it was. OIG craftily inserts the word "valid" to demean the effect. What does valid mean? Where is it defined in Federal regulations that a feasibility study is required? Again, OIG claims the County needed a Feasibility Study "to support its evaluation of the project and its costs." Yet, as we have shown above in Responses 11 and 12, no such evaluation is required. OIG apparently believes repetition of false requirements to support a false conclusion make it so.

⁴ Leveraging a significant amount of private investment was the first of three impacts listed in the handbook.

OIG Comments

20. There was no evidence that the County performed an independent evaluation to assess the prospects for the project's success.

Luzerne County's Response

There is no Federal requirement for an independent evaluation. However, CityVest retained a nationally recognized marketing analyst to perform a market analysis/evaluation. The market evaluation was available for the OIG to review and is still available in the County and the Justice Department offices. OIG ignored it. It was professionally prepared by a known expert. OIG refers to its conclusions as invalid.

OIG Comments

21. It was not clear what CityVest intended to do with the loan funds.

Luzerne County's Response

It seemed clear to Luzerne County. If the person performing the so-called Audit being discussed had any development experience, attended the public hearings or read the files, he would have realized the steps to be taken in using these funds. The funds were to be used to: buy the building(s), determine the market, determine the costs to preserve the building(s), make needed temporary repairs, and raise the capital to carry-out the project. Every cent was spent to these purposes. Every single expenditure was monitored prior to disbursement. No funds were spent which were not HUD eligible.

OIG Comments

22. However, the form did not provide sufficient evidence that the County performed a detailed evaluation of the project costs.

Luzerne County's Response

HUD regulations absolutely state no such evaluation is required. (See 24 CFR 570.209(a)).

OIG Comments

23. The list of funding sources totaled nearly \$22.4 million, including \$13 million in private funding. However, as stated above, the exact future use of the Hotel Sterling was unknown, and the financing for this project, as disclosed in the loan agreement, did not include private funds. Therefore, the relevance of the data on the spreadsheet was dubious.

Luzerne County's Response

We addressed this at Responses 15, 16, 18 and 21 in marketing performed. Furthermore, the terms of the project are in the Agreement. If there is no mention of

private funds, then they were not required. Such funds are required if the full project occurs NOT in the preliminary phase. Yet, OIG, several times, criticizes the County for not insuring/monitoring to determine a lack of private funds. If such funds were not required, why does OIG even discuss this? Monitoring of something not required is extra-legal.

OIG Comments

24. The Project Did Not Comply with HUD's Jurisdiction Requirements.

Luzerne County's Response

Jurisdiction is not defined in Part 570. The County Court House is 3 blocks from the Sterling Hotel. The City of Wilkes-Barre is located in Luzerne County. The Sterling paid taxes to Luzerne County. Furthermore, the County documents its determination as required at 24 CFR 570.309 in its formal resolutions to carry out this activity.

OIG Comments

25. The County had no documentation in its loan files to demonstrate that it properly monitored the project.

Luzerne County's Response

The files reviewed by OIG clearly show the monitoring performed. Every single bill was reviewed before approval. The files are replete with correspondence. Sometimes, goals are not achieved notwithstanding best intentions are "monitoring". 24 CFR 85.40(a) discusses monitoring. It required Luzerne County to be "responsible for managing the day to day operations of grant and subgrant supported activities." The files reviewed show that every transaction was reviewed and approved prior to expenditure of funds. Every request for payment was found to be for an "eligible activity" (use). This regulation goes on to say, "Grantee monitoring must cover each program, function or activity." It did. OIG does not point out a single ineligible use of funds or a misperformed function by CityVest or the County. Again, OIG uses the term "properly monitored", yet the regulations do NOT so state that those words as used by OIG. OIG ignores or is unaware of Lincoln Properties construction management or reports which are monitoring vehicles.

OIG Comments

26. On September 6, 2006, CityVest requested an additional \$2 million loan to supplement the \$4 million it had already received from the County for the project. On September 21, 2006, the County's board of commissioners granted preliminary approval to increase the amount of the loan because CityVest claimed that it needed the funds to enable it to proceed with the next redevelopment steps without delay. The project budget from the amended loan agreement showed that \$200,000 was budgeted for land or building acquisition (see appendix E), which was no increase from the original budget included in the original loan agreement, and \$500,000 was budgeted for professional and financial fees (see Appendix E), which an increase of \$400,000 from the budget included in the original loan agreement. However, as of September 2006, CityVest had spent \$525,000, more than two and a half times the

budgeted amount, on land or building acquisition and \$938,287, nearly twice as much the budgeted amount, on professional and financial fees (see appendix F). Moreover, although the project budget showed that \$4 million was budgeted for construction, which was an increase of \$1.5 million from the budget included in the original loan agreement, CityVest spent only \$67,739 on construction costs. CityVest spent \$3.2 million on demolition costs. Classifying these costs as construction costs rather than demolition costs, which is what they were, was misleading.

Luzerne County's Response

Every budget change was reviewed and approved. Evidence of line item approvals is in the files. OIG makes a point on the demolition costs to say they were classified in construction costs. While that is technically true on the form, it is because the pre-printed form had no demolition line. As we said previously, all work was inspected and approved prior to disbursement. The files clearly show demolition occurred. There was no attempt to deceive.

OIG Comments

27. The County should have reported the actual expense amounts to the board of commissioners and other involved parties.

Luzerne County's Response

All actual expense amounts were reported in the A-133 Audits, IDIS and the CAPERS. Several advertised public hearings were held on the Sterling. We cannot understand that the Auditor does not understand the processes of reporting. The Board of Commissioners receives, reviews and approves each expenditure at its monthly public meetings. No payment was sent to a vendor/borrower or other recipient that was not approved at the Commissioners weekly meeting attended by a quorum. Thus, the Commissioners knew who was being paid, the amount and the purpose. What more reporting to them could be required?

OIG Comments

28. The County had the ability to provide this information because it drew down Block Grant funds and released them to CityVest based upon the presentation of receipts by CityVest for approved expenditures.

Luzerne County's Response

The County NEVER drew any Block Grant funds at any time for the Sterling project. NO Block Grant funds were drawn for ANY business loan activity after 2000. We fail to understand how OIG can make such an error. Were the draw downs reviewed? The quarterly SF272's which are submitted to HUD clearly show that no Letter of Credit draws for the loan program occurred.

OIG Comments

29. The regulations at 24 CFR 570.209(c) state that if, after the grantee enters into a contract to provide assistance to a project, the scope or financial elements of the project change to the extent that a significant contract amendment is appropriate, the

project should be reevaluated under the guidelines of 24 CFR 570.209 and the recipient's guidelines. Without complete and accurate expenditure data, decision makers and other involved parties lacked significant information on which to evaluate the future of the project.

Luzerne County's Response

The very sub-section OIG quotes discusses "businesses" but OIG does not use the term. Logic would dictate that if an evaluation is not mandated at 24 CFR 570.209(a) initially, then why would a re-evaluation be required? More importantly, the trail of materials clearly shows that an evaluation did occur. It included a public hearing and a resolution of approval by the Commissioners.

OIG Comments

30. The County did not ensure that required Audits were performed. The County did not ensure that CityVest complied with the Audit requirements of Office of Management and Budget (OMB) Circular A-133 and its loan agreement. OMB Circular A-133 requires non-Federal entities that expend \$500,000 or more in Federal funds in any given fiscal year to have an independent audit conducted that complies with the requirements of the circular.

Luzerne County's Response

This statement is a gross error/misstatement. We list the actual regulation beginning in the next paragraph.

§ 85.26 Non-Federal audits.

(a) *Basic rule.* Grantees and subgrantees are responsible for obtaining audits in accordance with the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 to 7507) and revised OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The audits shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial audits.

(b) *Subgrantees.* State or local governments, as those terms are defined for purposes of the Single Audit Act Amendments of 1996, that provide Federal awards to a subgrantee which expends \$300,000 (Note: subsequently changed to \$500,000) or more (or other amount as specified by OMB) in Federal awards in a fiscal year, shall:

(1) Determine whether State or local subgrantees have met the audit requirements of the Act and whether subgrantees covered by OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," have met the audit requirements of the Act. Commercial contractors (private for-profit and private and governmental organizations) providing goods and services to State and local governments are not required to have a single audit performed. State and local governments should use their own procedures to ensure that the contractor has complied.

(2) Determine whether the subgrantee spent Federal assistance funds provided in accordance with applicable laws and regulations. *This may be accomplished by reviewing an audit of the subgrantee made in accordance with the Act, Circular A-133 (as set forth in 24 CFR Part 45), or through other means (e.g., program reviews) if the subgrantee has not had such an audit; (Emphasis added)*

(3) Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instance of noncompliance with Federal laws and regulations.

(4) Consider whether subgrantee audits necessitate adjustment of the grantee's own records; and

(5) Require each subgrantee to permit independent auditors to have access to the records and financial statements.

(c) *Auditor selection.* In arranging for audit services, § 85.36 shall be followed.

End of Regulation

Please note that § 85.26(b)(1) states that the County was required to determine whether the Federal funds were provided in accordance with the law. It then states: *"This may be accomplished by reviewing an audit of the subgrantee made in accordance with the Act, Circular A-133 (as set forth in 24 CFR Part 45), or through other means (e.g., program reviews) if the subgrantee has not had such an audit;"*

Thus, OIG intentionally has misstated the Federal requirements, namely that an Audit **MUST** be done. An Audit is optional. The regulation states (see bolded, italicized language above) in lieu of an Audit, "or, through other means (e.g., program reviews) if the subgrantee (CityVest) had not had such an Audit." One must wonder why the auditor misstates a regulation and what the motivation may be.

An A-133 Audit was prepared and submitted every year. It covered CityVest. OIG never asked to see them, yet they are available at the County and Jeffersonville, IN. Therefore, OIG is totally incorrect.

OIG Comments

31. The table below shows the expenditure of loan funds by CityVest's fiscal year.

CityVest fiscal year	Total loan Expenditures	OMB dollar threshold for audit
2003	\$284,657	\$300,000
2004	\$130,717	\$500,000
2005	\$311,027	\$500,000
2006	\$915,054	\$500,000
2007	\$3,690,122	\$500,000
2008	\$668,317	\$500,000
Total	\$5,999,894	

Luzerne County's Response

This chart serves no purpose. Its intent was to show an audit threshold had been exceeded and no required audit was done. As 85.26 shows, a non-federal audit is optional.

OIG Comments

32. CityVest incurred an unreasonable and unnecessary expense when it expended \$303,000 in loan funds to satisfy municipal liens on a property that it purchased, which was adjacent to the Hotel Sterling. The City of Wilkes-Barre filed the municipal liens on June 20, 2005, against the former property owner for demolition work. CityVest acquired the property on March 20, 2006. On December 1, 2006, the City billed CityVest \$303,000 to satisfy the liens. On March 12, 2007, the County drew down \$303,000 in Block Grant funds to pay the liens.

Luzerne County's Response

These are 2 different parcels of land; separate transactions. Thus, there is no unreasonable or unnecessary expense. The matter of the lien was discussed by OIG (see item 4 above and our Response 4). Once again, redundancy by OIG.

OIG Comments

33. Regulations at 2 CFR Part 225, appendix A(c)(1)(a) and (i), state that costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards and be the net of all applicable credits. Regulations at 2 CFR Part 225, appendix A(C)(2), state that a cost is reasonable if in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

Luzerne County's Response

This is a gross error by OIG. We attach 2 CFR, Sub-title A (Attachment A). We call attention to Section 1.210 of this sub-title. It states: "This sub-title contains guidance that directly applies only to Federal agencies." Then, in the chart below, at (e), is a listing of Chapter 1, Part 225 - the very section OIG cites is NOT applicable to Luzerne County. Section 2 CFR 225.35 states: "Agencies responsible for administering programs ... shall issue regulations to implement the provision of this part, and its appendices." This has never been done. To buttress this conclusion, 24 CFR 570.502, which lists all regulations applicable to CDBG, does NOT list 2 CFR 225 or its appendices as a requirement. Thus, OIG is grossly wrong. Also, this Part did not become effective until August 31, 2005. So, even if it was applicable, it could not be applied retroactively since the loan/grant was made over three (3) full years earlier.

OIG Comments

34. For this project, the national objective to be achieved was benefit to low-and moderate-income persons through job creation or retention activities. However, as of August 2012, the project was not complete, and no jobs had been created.

Luzerne County's Response

Once again, OIG does not understand the CDBG regulations. CityVest and Luzerne County had until 2022 to create the permanent jobs. As OIG should admit many temporary jobs were created but OIG does not acknowledge this. Furthermore, jobs are never created before a loan or grant, only during or after. OIG also states on Page 1, "after nearly 10 years and \$6 Million expended, the project won't meet its designated national objective of job creation."

Correct English would be that **"the project has not yet met its designated national objective with job creation."**

In this same vein, OIG, on pages 10 and 11, opines, without any basis, that the project is questioned as to whether it would meet its goal in the future. How can such a conclusion be reached? It is only an opinion by OIG and deserves no more weight than anyone else's opinion.

Likewise, OIG uses the same language on page 15.

OIG Comments

35. As of the date of this audit report, HUD headquarters had not made a decision regarding this project.

Luzerne County's Response

If HUD headquarters makes a decision supporting Luzerne County's position, OIG has wasted tens of thousands of dollars. Furthermore, Luzerne County has not been given an opportunity to participate in this process once it went to HUD HQ. OIG also discusses "sanctions". We believe this term is misused since none of the steps at 24 CFR 570.900(b)(5) or .910 have been concluded.

OIG Comments

36. Therefore, the \$6 million expended for this project was ineligible.

Luzerne County's Response

Once again, OIG uses a term, "ineligible" incorrectly. What was specifically "ineligible"?

There is only one (1) Federal Program whose regulations require repayment of the entire expenditure if projects are terminated. Such a requirement exists at 24 CFR 92.205(e) under the HOME Program.

(e) *Terminated projects.* A HOME assisted project that is terminated before completion, either voluntarily or otherwise, constitutes an ineligible activity and any HOME funds invested in the project must be repaid to the participating jurisdiction's HOME Investment Trust Fund in accordance with § 92.503(b) (except for project-specific assistance to community housing development organizations as provided in § 92.301(a)(3) and § 92.301(b)(3)).

OIG Comments

37. We recommend that the Director of HUD's Philadelphia Office of Community Planning and Development direct the County to
- 1A. Reimburse its business development loan program \$5,999,894 from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project.
 - 1B. Develop and implement comprehensive procedures for evaluating and underwriting proposed projects before approving applications for business development loans.
 - 1C. Develop and implement comprehensive procedures for effectively monitoring Block Grant-assisted activities.

Luzerne County's Response--

- 1A. There has been no showing that any of the funds discussed in this Audit were "Federal funds". Apparently, OIG assumes that all funds in the portfolio are CDBG related. They are not. What expenditures were ineligible? We checked every disbursement against the eligible activities permitted at 570.201 through .206 and none were not permitted. 570.207 lists ineligible uses of funds and none occurred in the Sterling project.

Most importantly, we do not know and OIG does not state a basis for this recommendation.

- 1B. We believe the procedures presently used meet HUD's criteria because 24 CFR 570.209 is not applicable.

- 1C. We believe our current monitoring procedures meet HUD's criteria.

Scope and Methodology**OIG Comment**

38. Obtained relevant background information.

Luzerne County's Comment

See Response 16 which shows OIG did NOT obtain relevant information. We do not know what was obtained, e.g., were the CityVest checking accounts/files obtained? Obviously, the other funds received were not audited.

OIG Comment

39. Reviewed HUD regulations at 24 CFR Part 570 regarding the Community Development Block Grant program and other applicable HUD regulations and guidance.

Luzerne County's Comment

As shown above, OIG may have reviewed HUD regulations in Part 570 but, it is obvious they failed to comprehend the plain English meaning in many instances and made up regulations in some instances.

OIG Comment

40. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Luzerne County's Comment

How can one conclude they have "a reasonable basis" if a major premise (i.e. – the regulations are misquoted, misunderstood or made up) does not exist? A simple syllogism fails if a premise is false.

Internal Controls**OIG Comment**

41. Based on our review, we believe that the following item is a significant deficiency:
- The County lacked comprehensive procedures for (1) evaluating and underwriting proposed projects before approving applications for business development loans, and (2) effectively monitoring Block Grant-assisted activities.

Luzerne County's Comment

If an evaluation is NOT required, why posit a requirement to change something; if monitoring occurred, why quibble over "effectively"?

OIG Comment

42. "INELIGIBLE"

Luzerne County's Comment

This is the only definition of this term we have seen, yet it does not appear in Part 570. However, we see no statement as to why the auditor believes the costs are not allowable. We clearly admit that the permanent jobs were not created yet.

There is no provision in HUD regulations, Federal, State or local policies and regulations that require repayment for a failed project. OIG is substituting a standard that does NOT exist. The remedies at law are available and are being pursued but, a super-remedy to repay ourselves is not required or suggested in any regulation. If a loan goes bad, only the contractual remedies are available absent fraud or gross action. All funds were spent for eligible HUD activities.

43. **Auditee Comments and OIG's Evaluation****Luzerne County's Response**

There does NOT appear to be ANY evaluation of our letter of September 28, 2012 or our prior submissions including our Response to the County Controller given to you in January 2012 or the Audit Survey Memo of this same time. It is our belief that OIG has a duty to state why our responses do not address their draft comments. Instead, OIG merely restated everything again. Of particular concern to Luzerne County is lack of response/explanation from OIG regarding our dispute on 24 CFR 570.209(a). The other comments are similarly treated.

As a specific example of the lack of care/interest by OIG generally is the comment 18 on page 30. OIG is correct, i.e. – they didn't mention it, Luzerne County did. No wonder our prior comments were brushed off. OIG doesn't even understand we made the comment or its impact on the issue.

CONCLUSION**Luzerne County's Conclusion**

We are disturbed by the lack of knowledge of the CDBG Program by employees who purportedly are professional auditors from OIG.

- They have no knowledge/understanding of 24 CFR 570.209.
- They have no knowledge that 24 CFR 85.26(b)(2), viz. an audit is absolutely not required. An alternative is permitted.
- They take an unwarranted position on 24 CFR 570.209 and use it to conclude that since a "proper evaluation (not required) was not done":
 - (a) repay the fund;
 - (b) change your loan procedures; and
 - (c) change monitoring procedures.
- They did not determine if CDBG funds were disbursed.
- They state CDBG funds were "drawn" when they were not.
- They did not examine CityVest's records.
- They mistake the acquisition of one property with another.
- They do not realize the CityVest project is not a loan but a deferred grant and there never was/is a requirement to repay \$6,000,000 if the "loan" did not meet its job goal. We clearly expect that the negotiations currently occurring will produce permanent jobs on this site. The exact number has yet to be determined.

We are puzzled by the conclusion because every single expenditure was for an eligible (570.201 to .206) activity. We clearly admit that the fundability goal (national objective) was not yet achieved. However, there has never been any HUD project where the national objective was required and met before funds were expended. The loan documents provide the only legal relief when there is a default. The loan documents and HUD requirements do not require the County to guarantee repayment in a default situation.

It is a settled matter that if a loan is made; funds are expended; the national objective is partially or fully achieved; and, the loan goes bad, i.e. – let's say, that \$500,000 is still owed on a \$600,000 loan, then the County would seek to recover those funds by whatever recourse was available under the loan agreement. Any funds not recovered would be written off.

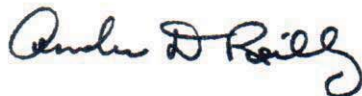
In this instance, the scenario is similar except that the permanent jobs have yet to be created, while many construction/professional jobs were. The Governing Body is seeking recovery of the asset which has substantial value both in cash, as well as development potential, including job creation. OIG ignores the fact that the transaction is not yet complete. The term is until 2022, yet OIG seeks a rush to judgment.

These things being so, there is no supportable premise for any of OIG's conclusions/recommendations.

It should be noted that CityVest's records, including Board Minutes, etc., were not available to OIG nor are they available to the County since they were subpoenaed by the U.S. Justice Department. We believe supportive information has been denied the County to further rebut OIG's allegations.

Please do not hesitate to contact me if you have any questions regarding this response and I look forward to working with you to resolve this matter in the County's favor.

Sincerely,



Andrew D. Reilly
Executive Director



PART 1—ABOUT TITLE 2 OF THE CODE OF FEDERAL REGULATIONS AND SUBTITLE A

Subpart A—Introduction to Title 2 of the CFR

- Sec.
1.100 Content of this title.
1.105 Organization and subtitle content.
1.110 Issuing authorities.

Subpart B—Introduction to Subtitle A

- 1.200 Purpose of chapters I and II.
1.205 Applicability to grants and other funding instruments.
1.210 Applicability to Federal agencies and others.
1.215 Relationship to previous issuances.
1.220 Federal agency implementation of this subtitle.
1.230 Maintenance of this subtitle.

Subpart C—Responsibilities of OMB and Federal Agencies

- 1.300 OMB responsibilities.
1.305 Federal agency responsibilities.

AUTHORITY: 31 U.S.C. 603; 31 U.S.C. 1111; 41 U.S.C. 405; Reorganization Plan No. 2 of 1970; E.O. 11641, 35 FR 10737, 3 CFR, 1966-1970, p. 939.

SOURCES: 69 FR 26280, May 11, 2004, unless otherwise noted.

Subpart A—Introduction to Title 2 of the CFR

§ 1.100 Content of this title.

This title contains—

- (a) Office of Management and Budget (OMB) guidance to Federal agencies on government-wide policies and procedures for the award and administration of grants and agreements; and
(b) Federal agency regulations implementing that OMB guidance.

§ 1.105 Organization and subtitle content.

(a) This title is organized into two subtitles.

(b) The OMB guidance described in § 1.100(a) is published in subtitle A. Publication of the OMB guidance in the CFR does not change its nature—it is guidance and not regulation.

(c) Each Federal agency that publishes regulations implementing the OMB guidance has a chapter in subtitle

B in which it issues those regulations. The Federal agency regulations in subtitle B differ in nature from the OMB guidance in subtitle A because the OMB guidance is not regulatory (Federal agency regulations in subtitle B may give regulatory effect to the OMB guidance, to the extent that the agency regulations require compliance with all or portions of the guidance).

§ 1.110 Issuing authorities.

OMB issues this subtitle. Each Federal agency that has a chapter in subtitle B of this title issues that chapter.

Subpart B—Introduction to Subtitle A

§ 1.200 Purpose of chapters I and II.

(a) Chapters I and II of subtitle A provide OMB guidance to Federal agencies that helps ensure consistent and uniform government-wide policies and procedures for management of the agencies' grants and agreements.

(b) There are two chapters for publication of the guidance because portions of it may be revised as a result of ongoing efforts to streamline and simplify requirements for the award and administration of grants and other financial assistance (and thereby implement the Federal Financial Assistance Management Improvement Act of 1999, Pub. L. 106-107).

(c) The OMB guidance in its initial form—before completion of revisions described in paragraph (b) of this section—is published in chapter II of this subtitle. When revisions to a part of the guidance are finalized, that part is published in chapter I and removed from chapter II.

§ 1.205 Applicability to grants and other funding instruments.

The types of instruments that are subject to the guidance in this subtitle vary from one portion of the guidance to another (note that each part identifies the types of instruments to which it applies). All portions of the guidance apply to grants and cooperative agreements, some portions also apply to other types of financial assistance or nonprocurement instruments, and some portions also apply to procurement contracts. For example, the:

§ 1.210**2 CFR Subtitle A (1-1-11 Edition)**

(a) Guidance on debarment and suspension in part 180 of this subtitle applies broadly to all financial assistance and other nonprocurement transactions, and not just to grants and cooperative agreements.

(b) Cost principles in parts 220, 225 and 230 of this subtitle apply to procurement contracts, as well as to financial assistance, although those principles are implemented for procurement contracts through the Federal Acquisition Regulation in title 48 of the CFR, rather than through Federal agency regulations on grants and agreements in this title.

[70 FR 51863, Aug. 31, 2005]

§ 1.210 Applicability to Federal agencies and others.

(a) This subtitle contains guidance that directly applies only to Federal agencies.

(b) The guidance in this subtitle may affect others through each Federal agency's implementation of the guidance, portions of which may apply to—

(1) The agency's awarding or administering officials;

(2) Non-Federal entities that receive or apply for the agency's grants or agreements or receive subawards under those grants or agreements; or

(3) Any other entities involved in agency transactions subject to the guidance in this chapter.

§ 1.215 Relationship to previous issuances.

Although some of the guidance was organized differently within OMB circulars or other documents, much of the guidance in this subtitle existed prior to the establishment of title 2 of the CFR. Specifically:

Guidance in . . .	On . . .	Previously was in . . .
(a) Chapter I, part 180	Nonprocurement debarment and suspension.	OMB guidance that conforms with the government-wide common rule (see 60 FR 33038, June 28, 1995).
(b) Chapter I, part 182	Drug-free workplace requirements	OMB guidance (54 FR 4948, January 31, 1989) and a government-wide common rule (as amended at 58 FR 66534, November 26, 2003).
(c) Chapter II, part 215	Administrative requirements for grants and agreements.	OMB Circular A-110.
(d) Chapter II, part 220	Cost principles for educational institutions.	OMB Circular A-21.
(e) Chapter II, part 225	Cost principles for State, local, and Indian tribal governments.	OMB Circular A-67.
(f) Chapter II, part 230	Cost principles for non-profit organizations.	OMB Circular A-122.
(g) [Reserved]		

[71 FR 28149, June 15, 2006]

§ 1.220 Federal agency implementation of this subtitle.

A Federal agency that awards grants and agreements subject to the guidance in this subtitle implements the guidance in agency regulations in subtitle B of this title and/or in policy and procedural issuances, such as internal instructions to the agency's awarding and administering officials. An applicant or recipient would see the effect of that implementation in the organization and content of the agency's announcements of funding opportunities and in its award terms and conditions.

§ 1.230 Maintenance of this subtitle.

OMB issues guidance in this subtitle after publication in the FEDERAL REGISTER. Any portion of the guidance that has a potential impact on the public is published with an opportunity for public comment.

Subpart C—Responsibilities of OMB and Federal Agencies

§ 1.800 OMB responsibilities.

OMB is responsible for:

(a) Issuing and maintaining the guidance in this subtitle, as described in § 1.230.

OMB Circulars and Guidance

§ 225.10

on the estimated amount of indirect costs allocated to Organized Research and the amount of the modified total direct cost base estimated to be incurred during the 8 months in which performance is scheduled to be commenced and completed. Such a proposal would be in violation of the requirements of this standard that the calculation of the amounts of both the indirect cost pools and the allocation bases be based on the educational institution's cost accounting period.

(b) An educational institution whose cost accounting period is the calendar year, installs a computer service center to begin operations on May 1. The operating expense related to the new service center is expected to be material in amount, will be accumulated in an intermediate cost objective, and will be allocated to the benefitting cost objectives on the basis of measured usage. The total operating expenses of the computer service center for the 8-month part of the cost accounting period may be allocated to the benefitting cost objectives of that same 8-month period.

(c) An educational institution changes its fiscal year from a calendar year to the 12-month period ending May 31. For financial reporting purposes, it has a 5-month transitional "fiscal year." The same 5-month period must be used as the transitional cost accounting period; it may not be combined, because the transitional period would be longer than 15 months. The new fiscal year must be adopted thereafter as its regular cost accounting period. The change in its cost accounting period is a change in accounting practices; adjustments of the sponsored agreement prices may thereafter be required.

(d) Financial reports are prepared on a calendar year basis on a university-wide basis. However, the contracting segment does all internal financial planning, budgeting, and internal reporting on the basis of a twelve month period ended June 30. The contracting parties agree to use the period ended June 30 and they agree to overhead rates on the June 30 basis. They also agree on a technique for prorating fiscal year assignment of the university's central system office expenses between such June 30 periods. This practice is permitted by the standard.

(e) Most financial accounts and sponsored agreement cost records are maintained on the basis of a fiscal year which ends November 30 each year. However, employee vacation allowances are regularly managed on the basis of a "vacation year" which ends September 30 each year. Vacation expenses are estimated uniformly during each "vacation year." Adjustments are made each October to adjust the accrued liability to actual, and the estimating rates are modified to the extent deemed appropriate. This use of a separate annual period for determining the amounts of vacation expense is permitted.

Attachment B to Appendix A—OASB's Disclosure Statement (DS-2) is available on the OMB Web site at http://www.whitehouse.gov/omb/grants/a21-appx_b.pdf

Attachment C to Appendix A—Documentation Requirements for Facilities and Administrative (F&A) Rate Proposals is available on the OMB Web site at http://www.whitehouse.gov/omb/grants/a21-appx_c.pdf

PARTS 221-224 [RESERVED]

PART 225—COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87)

- Sec.
- 225.5 Purpose.
- 225.10 Authority.
- 225.15 Background.
- 225.20 Policy.
- 225.25 Definitions.
- 225.30 OMB responsibilities.
- 225.35 Federal agency responsibilities.
- 225.40 Effective date of changes.
- 225.45 Relationship to previous issuance.
- 225.50 Policy review date.
- 225.55 Information Contact.

APPENDIX A TO PART 225—GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS

APPENDIX B TO PART 225—SELECTED ITEMS OF COST

APPENDIX C TO PART 225—STATE/LOCAL-WIDE CENTRAL SERVICE COST ALLOCATION PLANS

APPENDIX D TO PART 225—PUBLIC ASSISTANCE COST ALLOCATION PLANS

APPENDIX E TO PART 225—STATE AND LOCAL INDIRECT COST RATE PROPOSALS

AUTHORITY: 31 U.S.C. 503; 31 U.S.C. 1111; 41 U.S.C. 405; Reorganization Plan No. 2 of 1970; E.O. 11841, 35 FR 10737, 3 CFR, 1966-1970, p. 939.

SOURCE: 70 FR 51910, Aug. 31, 2005, unless otherwise noted.

§ 225.5 Purpose.

This part establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments (governmental units).

§ 225.10 Authority.

This part is issued under the authority of the Budget and Accounting Act

§225.15

of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; the Chief Financial Officers Act of 1990; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541 ("Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President").

§225.15 Background.

As part of the government-wide grant streamlining effort under Public Law 108-107, Federal Financial Award Management Improvement Act of 1999, OMB led an interagency workgroup to simplify and make consistent, to the extent feasible, the various rules used to award Federal grants. An interagency task force was established in 2001 to review existing cost principles for Federal awards to State, local, and Indian tribal governments; colleges and universities; and non-profit organizations. The task force studied "Selected Items of Cost" in each of the three cost principles to determine which items of costs could be stated consistently and/or more clearly.

§225.20 Policy.

This part establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award. Provision for profit or other increment above cost is outside the scope of this part.

§225.25 Definitions.

Definitions of key terms used in this part are contained in appendix A to this part, Section B.

§225.30 OMB responsibilities.

The Office of Management and Budget (OMB) will review agency regulations and implementation of this part, and will provide policy interpretations and assistance to insure effective and efficient implementation. Any excep-

2 CFR Ch. II (I-1-11 Edition)

tions will be subject to approval by OMB. Exceptions will only be made in particular cases where adequate justification is presented.

§225.35 Federal agency responsibilities.

Agencies responsible for administering programs that involve cost reimbursement contracts, grants, and other agreements with governmental units shall issue regulations to implement the provisions of this part and its appendices.

§225.40 Effective date of changes.

This part is effective August 31, 2005.

§225.45 Relationship to previous issuance.

(a) The guidance in this part previously was issued as OMB Circular A-87. Appendix A to this part contains the guidance that was in Attachment A (general principles) to the OMB circular; appendix B contains the guidance that was in Attachment B (selected items of cost); appendix C contains the information that was in Attachment C (state/local-wide central service cost allocation plans); appendix D contains the guidance that was in Attachment D (public assistance cost allocation plans); and appendix E contains the guidance that was in Attachment E (state and local indirect cost rate proposals).

(b) This part supersedes OMB Circular A-87, as amended May 10, 2004, which superseded Circular A-87, as amended and issued May 4, 1995.

§225.50 Policy review date.

This part will have a policy review three years from the date of issuance.

§225.55 Information contact.

Further information concerning this part may be obtained by contacting the Office of Federal Financial Management, Financial Standards and Reporting Branch, Office of Management and Budget, Washington, DC 20503, telephone 202-395-3993.

OMB Circulars and Guidance

Pl. 225, App. A

APPENDIX A TO PART 225—GENERAL
PRINCIPLES FOR DETERMINING AL-
LOWABLE COSTS

TABLE OF CONTENTS

A. Purpose and Scope	
1. Objectives	
2. Policy guides	
3. Application	
B. Definitions	
1. Approval or authorization of the award- ing or cognizant Federal agency	
2. Award	
3. Awarding agency	
4. Central service cost allocation plan	
5. Claim	
6. Cognizant agency	
7. Common rule	
8. Contract	
9. Cost	
10. Cost allocation plan	
11. Cost objective	
12. Federally-recognized Indian tribal gov- ernment	
13. Governmental unit	
14. Grantee department or agency	
15. Indirect cost rate proposal	
16. Local government	
17. Public assistance cost allocation plan	
18. State	
C. Basic Guidelines	
1. Factors affecting allowability of costs	
2. Reasonable costs	
3. Allocable costs	
4. Applicable credits	
D. Composition of Cost	
1. Total cost	
2. Classification of costs	
E. Direct Costs	
1. General	
2. Application	
3. Minor items	
F. Indirect Costs	
1. General	
2. Cost allocation plans and indirect cost proposals	
3. Limitation on indirect or administrative costs	
G. Interagency Services	
H. Required Certifications	
General Principles for Determining Allow- able Costs	
A. Purpose and Scope	
1. Objectives. This Appendix establishes principles for determining the allowable costs incurred by State, local, and federally- recognized Indian tribal governments (gov- ernmental units) under grants, cost reim- bursement contracts, and other agreements with the Federal Government (collectively referred to in this appendix and other appen- dices to 2 CFR part 225 as "Federal awards"). The principles are for the purpose of cost de- termination and are not intended to identify the circumstances or dictate the extent of Federal or governmental unit participation	

in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. Provision for profit or other increment above cost is outside the scope of 2 CFR part 225.

2. Policy guides.

a. The application of these principles is based on the fundamental premises that:

(1) Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices.

(2) Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.

(3) Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

b. Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering Federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee-for-service alternatives as a replacement for current cost-reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee-for-service approach to reduce the burden associated with maintaining systems for charging administrative costs to Federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes.

3. Application.

a. These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal awards (including subawards) except those with (1) publicly-financed educational institutions subject to, 2 CFR part 220, Cost Principles for Educational Institutions (OMB Circular A-21), and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring Federal agencies. However, 2 CFR part 225 does apply to all central service and department/agency costs that are allocated or billed to those educational institutions, hospitals, and other providers of medical care or services by other State and local government departments and agencies.

b. All subawards are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a governmental unit (other

Pl. 225, App. A

2 CFR Ch. II (1-1-11 Edition)

than a college, university or hospital), 2 CFR part 225 shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial organizations shall apply; if a subaward is to a college or university, 2 CFR part 220 (Circular A-21) shall apply; if a subaward is to a hospital, the cost principles used by the Federal awarding agency for awards to hospitals shall apply, subject to the provisions of subsection A.3.a. of this Appendix; if a subaward is to some other non-profit organization, 2 CFR part 230, Cost Principles for Non-Profit Organizations (Circular A-122), shall apply.

c. These principles shall be used as a guide in the pricing of fixed price arrangements where costs are used in determining the appropriate price.

d. Where a Federal contract awarded to a governmental unit incorporates a Cost Accounting Standards (CAS) clause, the requirements of that clause shall apply. In such cases, the governmental unit and the cognizant Federal agency shall establish an appropriate advance agreement on how the governmental unit will comply with applicable CAS requirements when estimating, accumulating and reporting costs under CAS-covered contracts. The agreement shall indicate that 2 CFR part 225 (OMB Circular A-87) requirements will be applied to other Federal awards. In all cases, only one set of records needs to be maintained by the governmental unit.

e. Conditional exemptions.

(1) OMB authorizes conditional exemption from OMB administrative requirements and cost principles for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

(2) To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of Appendix A subsection C.3 of 2 CFR part 225, Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87); Appendix A, Section C.4 of 2 CFR 220, Cost Principles for Educational Institutions (Circular A-21); Appendix A, subsection A.4 of 2 CFR 230 Cost Principles for Non-Profit Organizations (Circular A-122); and from all of the administra-

tive requirements provisions of 2 CFR part 215, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations (Circular A-110), and the agencies' grants management common rule.

(3) When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of 2 CFR part 225 (OMB Circular A-87), and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: Funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not used for general expenses required to carry out other responsibilities of a State or its subrecipients.

B. Definitions

1. "Approval or authorization of the awarding or cognizant Federal agency" means documentation evidencing consent prior to incurring a specific cost. If such costs are specifically identified in a Federal award document, approval of the document constitutes approval of the costs. If the costs are covered by a State/local-wide cost allocation plan or an indirect cost proposal, approval of the plan constitutes the approval.

2. "Award" means grants, cost reimbursement contracts and other agreements between a State, local and Indian tribal government and the Federal Government.

3. "Awarding agency" means (a) with respect to a grant, cooperative agreement, or cost reimbursement contract, the Federal agency, and (b) with respect to a subaward, the party that awarded the subaward.

4. "Central service cost allocation plan" means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.

5. "Claim" means a written demand or written assertion by the governmental unit or grantor seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of award terms, or other relief arising under or relating to the award. A voucher, invoice or other routine request for payment that is not a dispute when submitted is not a claim. Appeals, such as those filed by a governmental unit in response to questioned audit costs, are not considered claims until a final management decision is made by the Federal awarding agency.

OMB Circulars and Guidance

Pl. 225, App. A

6. "Cognizant agency" means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under 2 CFR part 225 on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies.

7. "Common Rule" means the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). Other common rules will be referred to by their specific titles.

8. "Contract" means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include (but are not limited to): Awards and notices of awards; job orders or task orders issued under basic ordering agreements; letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and, bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301 *et seq.*

9. "Cost" means an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency. It does not include transfers to a general or similar fund.

10. "Cost allocation plan" means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. Each of these terms is further defined in this section.

11. "Cost objective" means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred.

12. "Federally-recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 65 Stat. 638) certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs.

13. "Governmental unit" means the entire State, local, or federally-recognized Indian tribal government, including any component thereof. Components of governmental units may function independently of the governmental unit in accordance with the term of the award.

14. "Grantee department or agency" means the component of a State, local, or federally-recognized Indian tribal government which is responsible for the performance or adminis-

tration of all or some part of a Federal award.

15. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Appendix B of 2 CFR part 225.

16. "Local government" means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under State law), any other regional or interstate government entity, or any agency or instrumentality of a local government.

17. "Public assistance cost allocation plan" means a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs to all of the programs administered or supervised by State public assistance agencies as described in Appendix D of 2 CFR part 225.

18. "State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the provisions of 2 CFR part 225.
- c. Be authorized or not prohibited under State or local laws or regulations.
- d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
- f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- g. Except as otherwise provided for in 2 CFR part 225, be determined in accordance with generally accepted accounting principles.
- h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
- i. Be the net of all applicable credits.
- j. Be adequately documented.

Pt. 225, App. A

2 CFR Ch. II (1-1-11 Edition)

2. Reasonable costs. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded. In determining reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.

b. The restraints or requirements imposed by such factors as: Sound business practices; arm's-length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award.

c. Market prices for comparable goods or services.

d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.

e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

3. Allocable costs.

a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.

b. All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in 2 OFR part 225 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.

d. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Appendices C, D, and E to this part.

4. Applicable credits.

a. Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: Purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate

to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

b. In some instances, the amounts received from the Federal Government to finance activities or service operations of the governmental unit should be treated as applicable credits. Specifically, the concept of netting such credit items (including any amounts used to meet cost sharing or matching requirements) should be recognized in determining the rates or amounts to be charged to Federal awards. (See Appendix B to this part, item 11, "Depreciation and use allowances," for areas of potential application in the matter of Federal financing of activities.)

D. Composition of Cost

1. Total cost. The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.

2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow.

B. Direct Costs

1. General. Direct costs are those that can be identified specifically with a particular final cost objective.

2. Application. Typical direct costs chargeable to Federal awards are:

a. Compensation of employees for the time devoted and identified specifically to the performance of those awards.

b. Cost of materials acquired, consumed, or expended specifically for the purpose of those awards.

c. Equipment and other approved capital expenditures.

d. Travel expenses incurred specifically to carry out the award.

3. Minor items. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of cost is consistently applied to all cost objectives.

E. Indirect Costs

1. General. Indirect costs are those incurred for a common or joint purpose benefiting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by

OMB Circulars and Guidance

Pl. 225, App. B

other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2. Cost allocation plans and indirect cost proposals. Requirements for development and submission of cost allocation plans and indirect cost rate proposals are contained in Appendices C, D, and E to this part.

3. Limitation on indirect or administrative costs.

a. In addition to restrictions contained in 2 CFR part 225, there may be laws that further limit the amount of administrative or indirect cost allowed.

b. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.

G. *Interagency Services.* The cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rata share of indirect costs. A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums, and fringe benefits) may be used in lieu of determining the actual indirect costs of the service. These services do not include centralized services included in central service cost allocation plans as described in Appendix C to this part.

H. *Required Certifications.* Each cost allocation plan or indirect cost rate proposal required by Appendices C and E to this part must comply with the following:

1. No proposal to establish a cost allocation plan or an indirect cost rate, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be acceptable unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan or Certificate of Indirect Costs as set forth in Appendices C and E to this part. The certificate must be signed on behalf of the governmental unit by an individual at a level no lower than chief financial officer of the governmental unit that submits the proposal or component covered by the proposal.

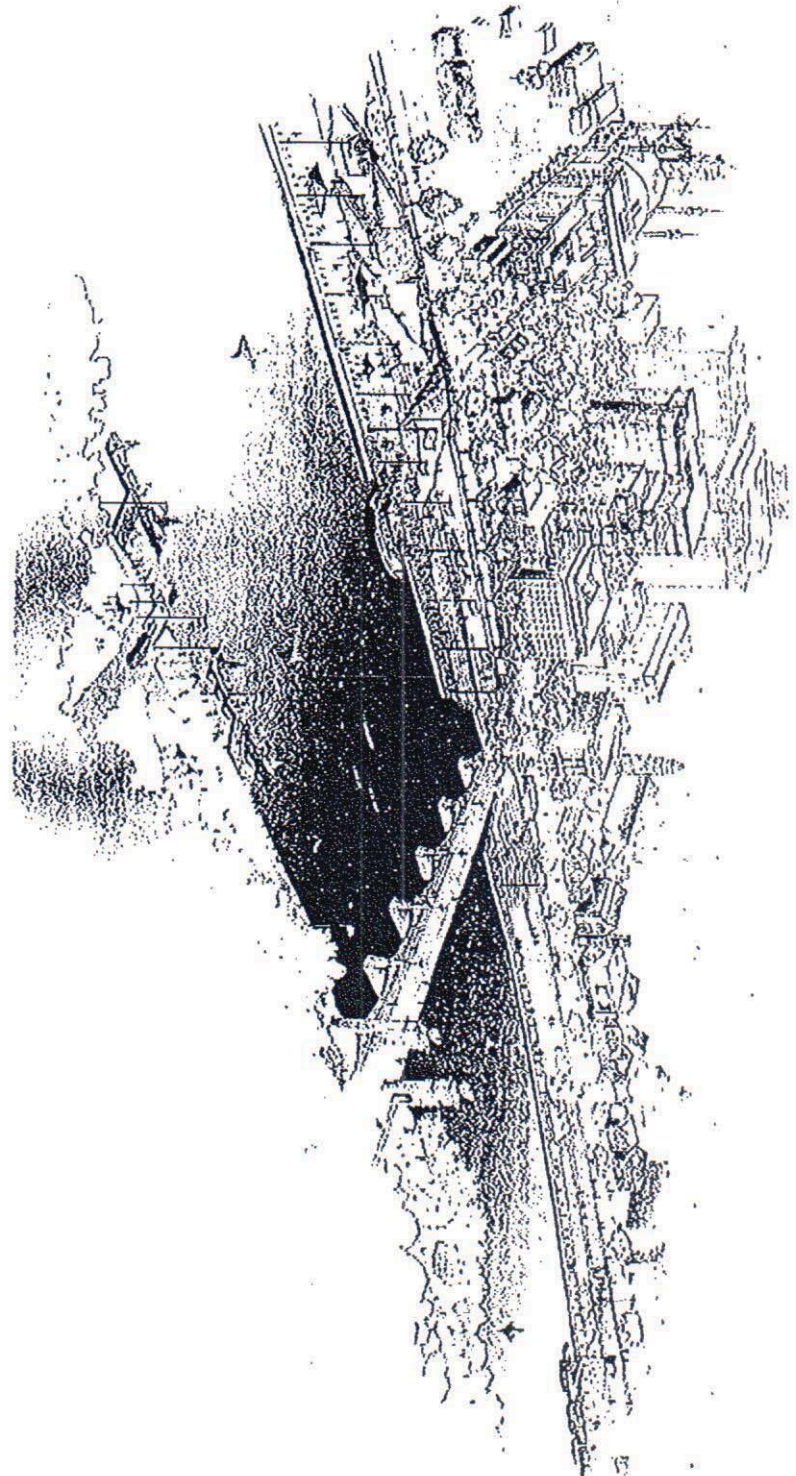
2. No cost allocation plan or indirect cost rate shall be approved by the Federal Government unless the plan or rate proposal has been certified. Where it is necessary to establish a cost allocation plan or an indirect cost rate and the governmental unit has not submitted a certified proposal for estab-

lishing such a plan or rate in accordance with the requirements, the Federal Government may either disallow all indirect costs or unilaterally establish such a plan or rate. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate established will be set to ensure that potentially unallowable costs will not be reimbursed.

APPENDIX B TO PART 225—SELECTED ITEMS OF COST

TABLE OF CONTENTS

1. Advertising and public relations costs
2. Advisory councils
3. Alcoholic beverages
4. Audit costs and related services
5. Bad debts
6. Bonding costs
7. Communication costs
8. Compensation for personal services
9. Contingency provisions
10. Defense and prosecution of criminal and civil proceedings, and claims
11. Depreciation and use allowances
12. Donations and contributions
13. Employee morale, health, and welfare costs
14. Entertainment costs
15. Equipment and other capital expenditures
16. Fines and penalties
17. Fund raising and investment management costs
18. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs
19. General government expenses
20. Goods or services for personal use
21. Idle facilities and idle capacity
22. Insurance and indemnification
23. Interest
24. Lobbying
25. Maintenance, operations, and repairs
26. Materials and supplies costs
27. Meetings and conferences
28. Memberships, subscriptions, and professional activity costs
29. Patent costs
30. Plant and homeland security costs
31. Pre-award costs
32. Professional service costs
33. Proposal costs
34. Publication and printing costs
35. Rearrangement and alteration costs
36. Reconversion costs
37. Rental costs of building and equipment
38. Royalties and other costs for the use of patents



Sterling Feasibility Study

Prepared for Oryxco, June 15, 2001

Bethin Cywinski Jackson

Architectural Planning, Interior Design

THE OPPORTUNITY

Cayfish, Inc., the Wytheville Valley Community Development Corporation, is pleased to present a remarkable investment development opportunity in downtown Wytheville, Pennsylvania.

The site - one of the most prominent in Northeastern Pennsylvania - serves as the western gateway to Wilkes-Barre, the seat of Luzerne County, and the heart of the nation's 6th largest metropolitan area. With a working population of over 15,000, Wilkes-Barre is Pennsylvania's fifth largest downtown employment center. In 1970, Expansion Management Alliance named Wilkes-Barre one of "America's 50 Most Challenging Business Locations and Expansion."

The site overlooks the Susquehanna River and the historic Market Street Bridge, which connects Wilkes-Barre to neighboring Scranton on the western side of the Susquehanna. The site is also situated one block from Public Square, the park that serves as the heart of Wilkes-Barre's downtown. The campuses of Kings College and Wilkes University - with a combined student population exceeding 5,000 - are just one block away, as is the renowned Kelly Center for the Performing Arts. The First United America, home to the AHA, Wilkes-Barre/Scranton Penguins, is within a five-minute drive.

The site enjoys easy access to highways 61, 82, and 476, while the Wilkes-Barre/Scranton International Airport is minutes away. Wilkes-Barre is strategically located - more than 40% of the nation's population lives within 600 miles - the region's cost of living is considerably lower than that of major metropolitan areas.

Existing downtown development projects surround the site. Directly across the street, an elaborate reconstruction of the historic Overlook is underway. This project, which will soon begin allowing the Susquehanna River to serve as a major amenity for the Wilkes-Barre region, will include walking and bicycle trails, a local landing area, performance spaces. Through the new lower level will provide every pedestrian access to the downtown waterfront. The renewed investment is part of a \$200 million river redevelopment, now nearing completion, which will provide superior flood protection along the section of the Susquehanna.

In addition, Federal authorization and funding has been secured for the construction of an inflatable dam, just south of the site, in order to create a controlled water level during the recreational season. This resulting lake will be 400 acres in size, and will extend for a 1/2 mile along the Susquehanna.

Steps away from the site, the Susquehanna River provides an existing river regional cultural attraction, is taking shape. Investors will have the advantage of parking facilities that will serve development at the subject site. Together, these projects will transform the downtown investment - and ensure that the site provides a superior development opportunity.

The site is large enough to include Class A commercial office space, hotel, and high-income residential uses. Preliminary development studies have been prepared for the site, and they serve as the basis for design guidelines that govern site development.

THE UNIQUE ECONOMIC ADVANTAGES

The site's unique economic advantages include:

Keynote Opportunity Zone

The site has been designated a Keynote Opportunity Zone property by the Commonwealth of Pennsylvania. The KOPZ Program is an incentive program that provides tax and local taxes on the site for over a decade. The tax abatement applies to the property owner, to businesses operating in a KOPZ property, and to residents of a KOPZ property. Applicable taxes include:

- Pennsylvania Corporate Net Income Tax
- Pennsylvania Capital Stock and Foreign Franchise Tax
- Pennsylvania Personal Income Tax
- Pennsylvania Sales and Use Tax (on commercial)
- Local Real Property Tax
- Local Earned Income Tax
- Local Motor Vehicle Tax

New Markets Tax Credit

The site is also a qualified zone for the New Markets Tax Credit, a new Federal program designed to bridge financing gaps and spur economic development. The program provides tax credits for investments in businesses, and government and nonprofit jobs, services, and physical infrastructure. Established in December of 2001, New Markets Tax Credits are authorized for a total of \$15 billion in private investments by 2017, starting with \$1 billion this year. New Markets Tax Credits are available to equity investors in "Community Development Entities" (CDEs), which in turn will use the proceeds to make loans and investments in businesses located in targeted communities. By making an equity investment in an eligible CDE, individual and corporate investors can receive a New Markets Tax Credit worth 30 percent for the first value added, and their investment over the life of the credit.

THE SPONSOR

Cayfish is a not-for-profit, community development organization, based in Wilkes-Barre, Pennsylvania, whose mission is to undertake housing, commercial, academic, and important development projects to address the economic revitalization of Northeastern Pennsylvania's "Gateway Valley" - particularly the downtown urban centers of Wilkes-Barre, Hazleton, and Pittston. We act as a developer of the area, and are involved in the acquisition, rehabilitation, and sale or rental of dilapidated and underutilized residential and commercial properties.

Formed in September 2006, Cayfish is a partnership of the local business, civic, and academic communities. Its Board of Directors includes the President of Kings College in downtown Wilkes-Barre (representing all of the presidents of local higher education institutions), a lawyer from a distinguished Wilkes-Barre based law firm, the chief executives of two local financial institutions, the Chairman of the Wilkes-Barre Redevelopment Authority, and the owner of a downtown Wilkes-Barre restaurant who also has more than 20 years of local and federal economic development experience.

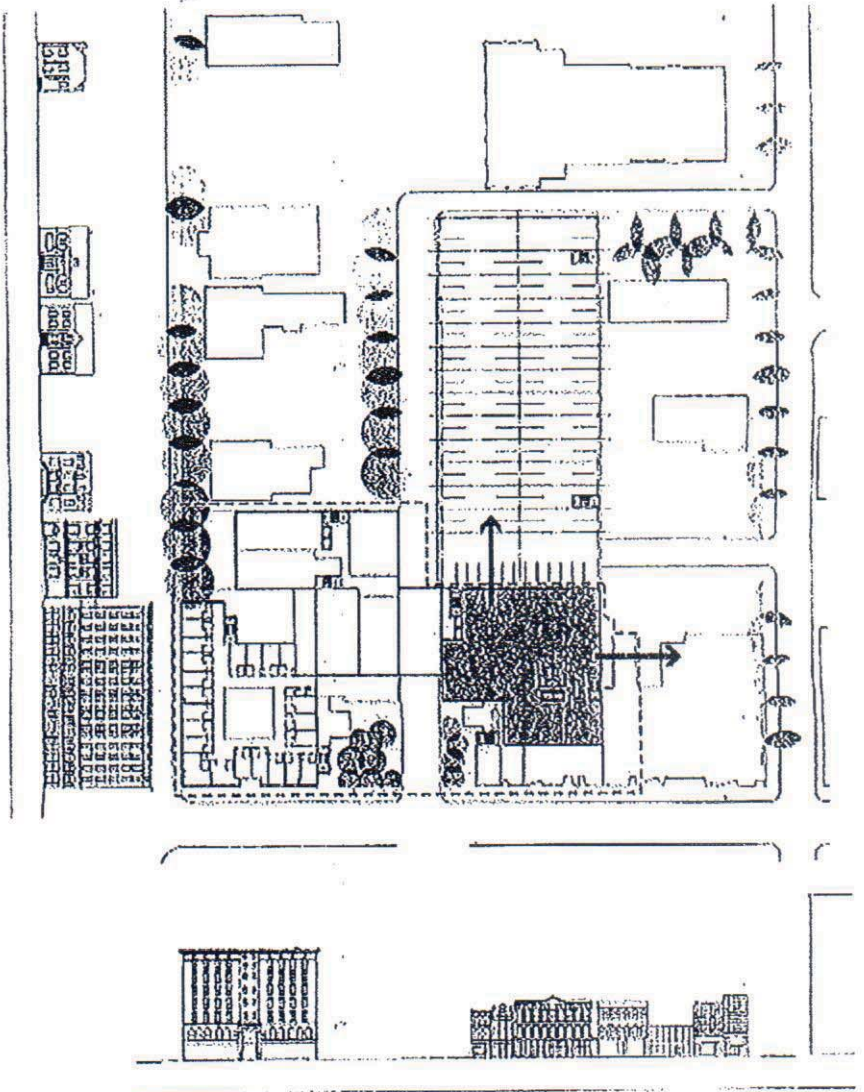
Cayfish seeks to blend public and private financial resources for its economic revitalization projects. As a local non-profit developer and local agent, we seek to promote economic activity and house ownership in our region's urban centers, to eliminate blight and vacancy, and to act as a catalyst for economic revitalization. Concerned in the spirit of strengthening the relationship between our local higher education institutions, the business community, and the region, Cayfish will promote development projects that enhance economic growth, business development, educational opportunities, urban housing resources, and a clean and safe environment.

Cayfish welcomes inquiries:

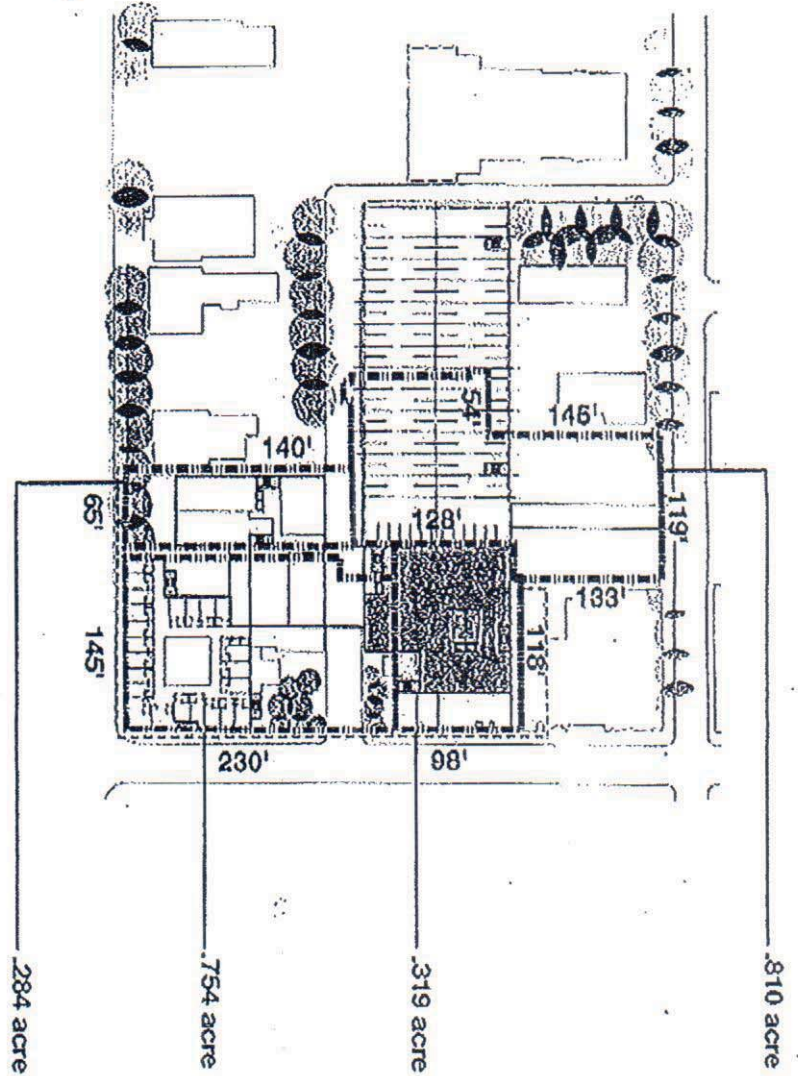
Cayfish, Inc.
The Shryver Building
7 N. Wilkes-Barre Boulevard, Suite 4224
Wilkes-Barre, PA 18702
Phone: 570-826-6343
Fax: 570-826-6376

Sterling Feasibility Study
Prepared for CH2M, June 15, 2001

Borish Orynski Jackson
Architectural Planning, Interior Design



29 28 27 26 25 24 23 22 21 20 19 18 17 16 15 14 13 12 11 10 9 8 7 6 5 4 3 2 1



Sterling Feasibility Study

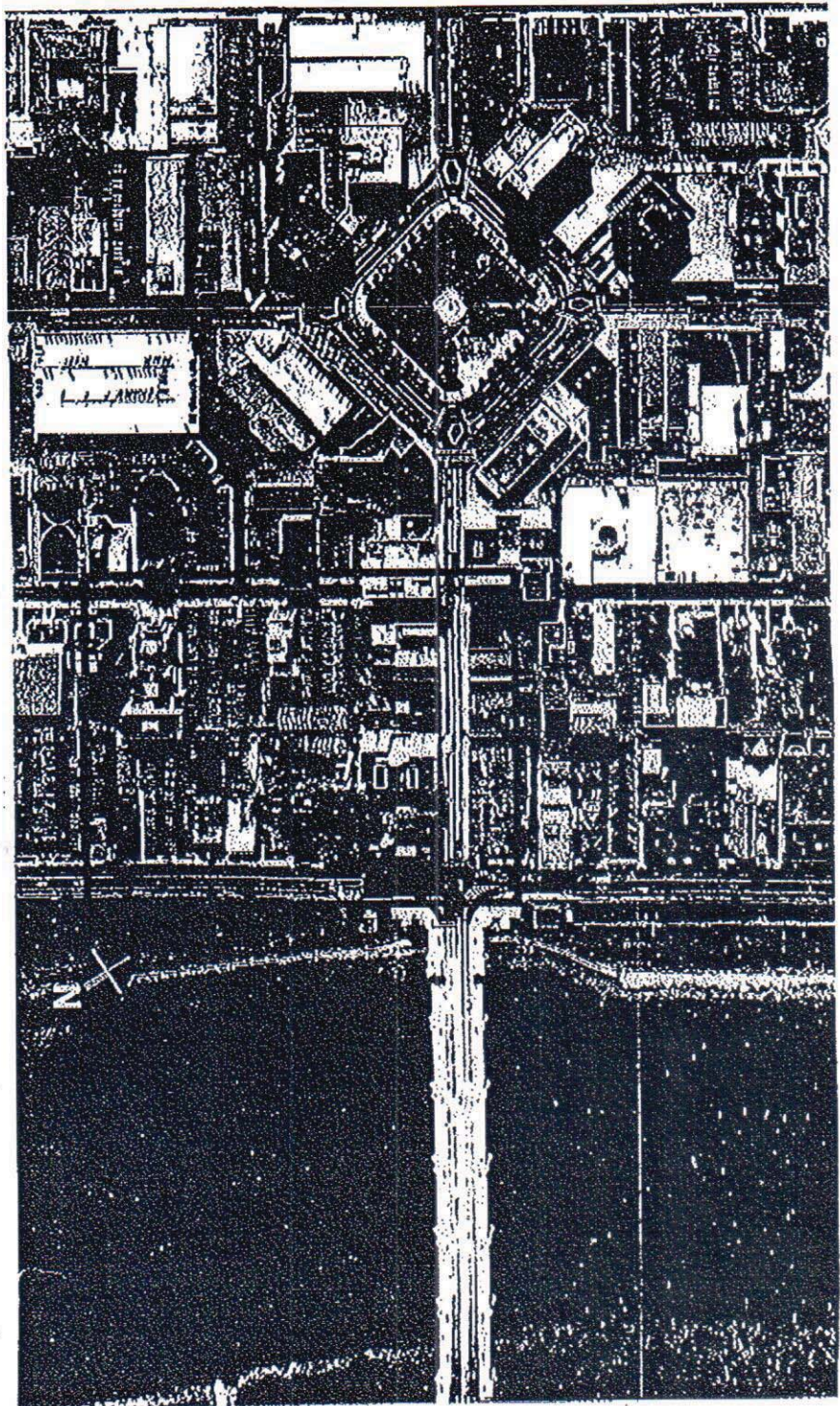
Prepared for CityWest, June 15, 2001

Bohlin Cywinski Jackson

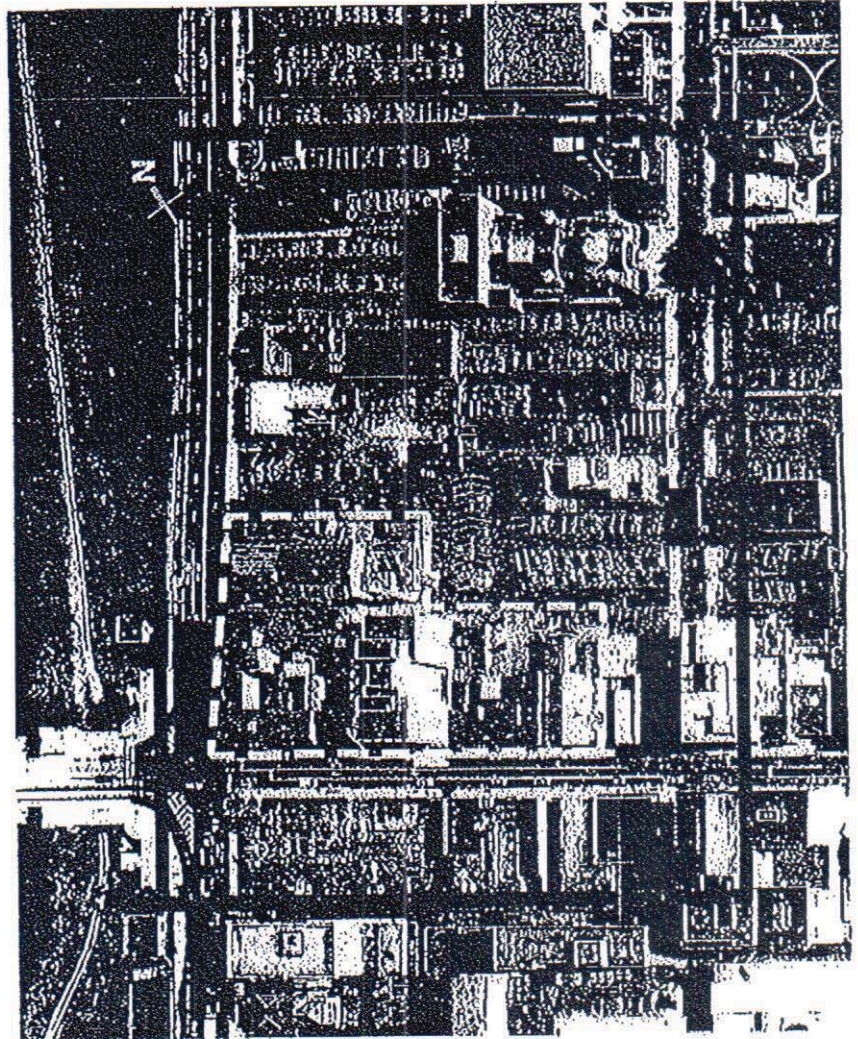
Architectural Planning Interior Design

Sterling Feasibility Study
Prepared for City of St. Paul, June 15, 2001

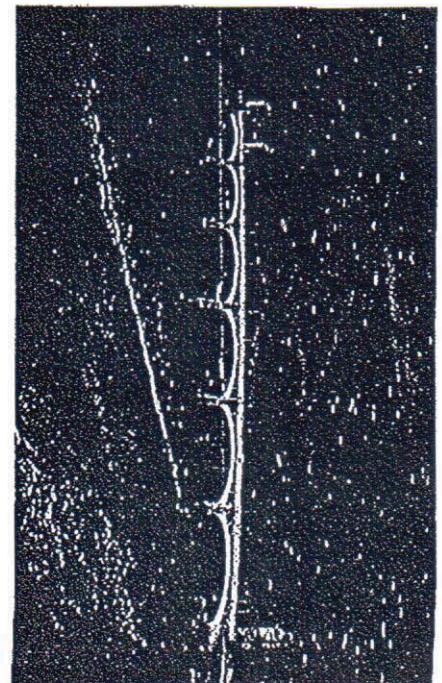
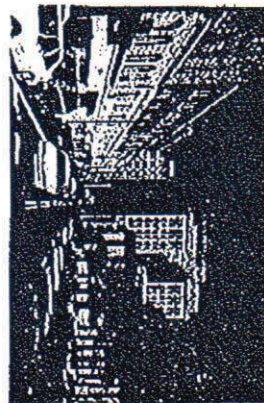
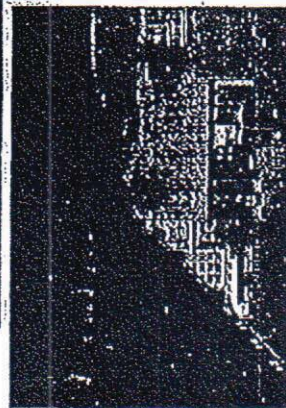
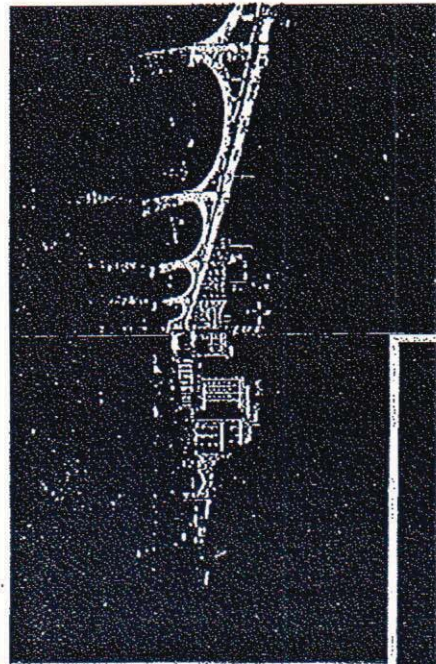
Bonita Cywinski Jackson
Architectural Planning, Interior Design



Sterling Feasibility Study
Prepared for CityWest, June 15, 2005



Ehlin O'Connell Jackson
Architecture Planning Interior Design

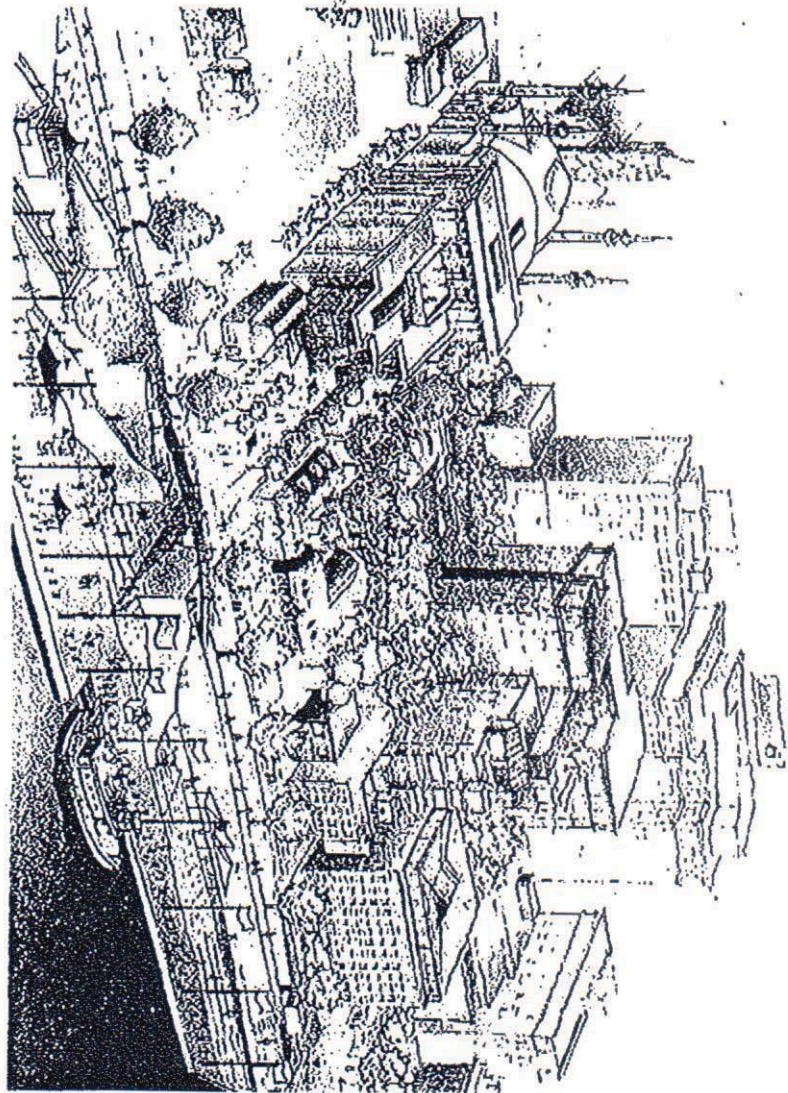


Sterling Feasibility Study

Prepared for City of St. Louis, June 15, 2001

Bolin Cyrenski Jackson

Architectural Planning and Interior Design



Sterling Feasibility Study

Prepared for CityWest, June 15, 2001

Bohlin Cywinski Jackson

Architecture Planning Interior Design

Sterling Hotel Redevelopment
Sample Budget Scenario: Site Considerations
August 2, 2009
DRAFT

Site Preparation	Chicago 7 Story, Live and Care		Existing 14		Patio Deck		Shedding Area		Loggia Barbecue		
Grass Area	Duration	Est. Budget	Site Budget	Site Budget	Est. Budget	Site Budget	Est. Budget	Site Budget	Est. Budget	Site Budget	Total
	97,000	16,000	85,000	85,000	6,000	25,000	30,000	30,000	6,000	6,000	491,000
	SS%	7%	0%	0%	0%	30%	30%	30%	0%	0%	59,500
	Portion Reserved	34,000	-	-	-	8,000	11,000	-	-	-	29,000
	Portion to remain	-	-	-	-	-	-	-	-	-	-
Asbestos (below)	3	10,000	960,000	120,000	1,200,000	1	60,000	550,000	350,000	40,000	2,770,000
Lead Paint Abatement (above)	3	2,500	119,000	-	-	1	28,000	28,000	28,000	-	130,000
Dioxin Remediation	3	6,000	704,000	124,000	650,000	1	40,000	200,000	1	280,000	2,100,000
Remediation Dynamics	3	20,000	690,000	-	-	1	-	-	1	280,000	690,000
Site Cleanup and Grading	3	50,000	-	-	-	-	-	-	-	-	50,000
		\$2,500									
Subtotal Construction Cost		\$2,500,000	\$224,000	\$1,500,000		\$478,000	\$567,000	\$122,000		\$10,200,000	\$10,200,000

Sterling Hotel Redevelopment
Sample Budget Scenario: Project Construction Components
August 2, 2009
DRAFT

Item	Unit Cost	Area (sq. ft.)	Cost
Hotel			
Reconfigure Existing Hotel Space	\$ 120	32,000	\$ 3,840,000
Reconfigure Existing Lobby	\$ 180	5,000	\$ 900,000
New Hotel Space	\$ 115	25,000	\$ 2,875,000
Reconfigure Restaurant	\$ 200	12,000	\$ 2,400,000
Convert Upper Court to Kitchen	\$ 160	5,000	\$ 800,000
New Support Space	\$ 25	6,000	\$ 150,000
Substructure Pool, Stairwells, etc.	\$ 100,000	1.5	\$ 100,000
Total Construction Cost			\$ 11,965,000
Cost Per Room, Based on	124	84,000	\$ 82,000

Item	Unit Cost	Area (sq. ft.)	Cost
Mezzanine			
Reconfigure front of building for mezzanine	\$ 125	17,000	\$ 2,125,000
New Mezzanine Space	\$ 115	82,400	\$ 9,476,000
New Support Space	\$ 65	6,000	\$ 390,000
Island	\$ 70	4,000	\$ 280,000
Total Construction Cost			\$ 11,771,000
Cost Per Unit Based on	4.1 units	7,200 to 2,400 sq. ft.	\$ 2,871,000

Item	Unit Cost	Area (sq. ft.)	Cost
Other			
Reconfigure front of Perry Block	\$ 135	5,000	\$ 675,000
Reconfigure front of Perry Block	\$ 110	160,000	\$ 17,600,000
Total Construction Cost			\$ 18,275,000

Item	Unit Cost	Area (sq. ft.)	Cost
Finishing			
Finishing	\$ 5,000	120	\$ 600,000
Finishing	\$ 24,500	420	\$ 10,290,000
Finishing	\$ 15,000	420	\$ 6,300,000
Finishing	\$ 18,500	960	\$ 17,720,000
Total Construction Cost			\$ 24,910,000

Item	Unit Cost	Area (sq. ft.)	Cost
Site Work			
Site Work	\$ 45	12,000	\$ 540,000
Site Work	\$ 20	75,000	\$ 1,500,000
Site Work	\$ 50	13,000	\$ 650,000
Site Work	\$ 100	200,000	\$ 20,000,000
Total Construction Cost			\$ 22,690,000

Seeking Hotel Redevelopment
Sample Budget Scenario: 50% Costs and Summary
August 2, 2006
DRAFT

Construction Cost Summary			1990
	New	Restoration	
Site Preparation	\$6,400,000		\$6,400,000
Hotel	\$5,400,000	\$4,700,000	\$11,100,000
Wearing Surface	\$16,361,000	\$1,207,000	\$17,568,000
Office	\$17,600,000	\$1,500,000	\$19,100,000
Parking	\$17,200,000		\$17,200,000
Site Work	\$2,000,000		\$2,000,000
	\$60,560,000	\$8,207,000	\$68,767,000
Cost Per Square Foot Based On	356,400		\$152

Design Fee Summary			Total Design Cost
	New	Restoration	
Site Preparation	\$470,000		\$470,000
Hotel	\$500,000	\$530,000	\$1,030,000
Wearing Surface	\$120,000	\$127,000	\$247,000
Office	\$1,270,000	\$100,000	\$1,370,000
Parking	\$1,220,000		\$1,220,000
Site Work	\$700,000		\$700,000
	\$4,160,000	\$757,000	\$4,917,000
Cost Per Square Foot Based On	356,400		\$14

	Total Project Cost
Project Cost Summary	
Construction Cost	\$68,465,025
Design Cost	\$5,591,090
Material	\$72,232,030
Contingency	10.05%
Developer's Cost	6.59%
Subtotal	\$145,503,002
Services due to NOD fee seller unit	-3%
	\$4,365,090
Net Project Cost	\$141,137,912

ROBERT C. LAWTON
County Manager

COUNTY COUNCIL

JAMES BOBECK, CHAIRMAN
LINDA MCCLOSKEY HOUCK, VICE CHAIRMAN
EDWARD A. BROMINSKI
ELAINE MADDON CURRY
HARRY HAAS
EUGENE L. KELLEHER
TIM MCGINLEY
RICK MORELLI
STEPHEN A. URBAN
STEPHEN J. URBAN
RICK WILLIAMS



COUNTY of LUZERNE
PENNSYLVANIA
ESTABLISHED 1786

ANDREW D. REILLY
Executive Director

E-MAIL:
luzcood@luzernecounty.org

OFFICE OF COMMUNITY DEVELOPMENT
54 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2910 TDD: 570.825.1860

September 28, 2012

Mr. John P. Buck
U.S. Department of Housing and Urban Development
Office of Inspector General
Regional Inspector General for Audit
100 Penn Square East, Suite 10205
Philadelphia, PA 19107

RE: Draft Audit Response

Dear Mr. Buck:

I am writing to respond to the Draft Audit of Luzerne County's Community Development Block Grant Business Development Loan Program. I would however, first like to thank you for the professionalism you displayed by Greg Burgwald in working with my office on the difficult task of auditing this very successful program.

It is important to note that Luzerne County's Business Development Loan Program (BDLP), which started in 1982, has a portfolio valued at \$48.5 million. Since its inception, the Program has funded 669 loans totaling \$235,690,576, with a CDBG investment of \$26.3 million, the last of which was drawn from Treasury in 2000. These loans created 16,613 jobs, of which 12,921 are low/mod (78%), and 5,343 jobs were retained. The cost per job is \$14,187.12. These facts were included our June 19th letter to Mr. Burgwald as well as, Ms. Jane Vincent and Mr. Nadab Bynum of the Regional Office on June 29th and Mr. Burgwald on July 3rd. We were expecting that our complete response would be incorporated in the "Draft" Audit, but they were not.

First we would like to comment regarding the purposes of the Audit as follows:

What RIGA audited and Why----the then newly elected County Controller filed a complaint with HUD alleging misappropriation of funds as well as your personal review of certain dated files.

Luzerne County Comment

Misappropriate means that the funds were turned to a wrong purpose. This is an important point in view of the Controller's audit which showed no funds missing. Perhaps, the word "misappropriate" should be changed to a more appropriate description of what is alleged to have occurred. Furthermore while much information can be gathered from IDIS data, the IDIS system

is not regulated therefore the information drawn from that source is not an official record of HUD.

What RIGA Found--- The Finding claims Luzerne County did not PROPERLY (emphasis added) evaluate and underwrite the \$6 Million loan to City Vest and the project did not meet its job creation goal.

Luzerne County Comment

- a) The word "properly" does not appear in any HUD regulation.
- b) Although OIG claims 24 CFR 570.209(a) is applicable notwithstanding language that states HUD's suggested Guidelines "are not mandatory" and that "use" of HUD's Guidelines or a local standard by Luzerne County is required "to conduct basic underwriting prior to the provision of CDBG financial assistance to a FOR-PROFIT BUSINESS (emphasis added)." City Vest is a not-for-profit entity. Thus, there is no HUD requirement at 570.209(a) applicable to City Vest however, a thorough evaluation was done.
- c) Furthermore, a "basic evaluation occurred." Prior to the loan application being submitted, the County and City Vest received a feasibility study by a nationally known architect (who happens to be in Wilkes-Barre and Philadelphia) which evaluated both the structure and costs to cure. It was prepared in June, 2001 prior to the loan application (copy attached). It is a thorough evaluation. The OCD also submitted a written "evaluation" to the Commissioners prior to their approval on October 16, 2002.

What RIGA Recommended---HUD require the County to repay the Program with non-Federal funds and adopt BLDP Procedures to improve the Program Requirements.

Luzerne County Response

The County has had BLDP procedures in place for over 35 years and continues to update same to meet current needs and HUD requirements.

The BLDP funding for this Project and all projects undertaken since 2000 include no U.S. Treasury originated CDBG funds. Loan repayment from this Project and those in the future will continue to be funded from recycled BLDP funds therefore no repayment is required or necessary.

DRAFT AUDIT FINDING

THE COUNTY DID NOT PROPERLY EVALUATE, UNDERWRITE, AND MONITOR A HIGH RISK LOAN

1. RIGA claims the County only conducted a cursory level of underwriting.
2. RIGA claims the County lacked a Plan for the Sterling.
3. RIGA claims the County and City Vest should have had other funds in place to share the financial burden.

4. RIGA claims the County did not Properly Assess Project Feasibility and Evaluate Cost of the Project.
5. RIGA claims the Project did not comply with HUD's Jurisdiction Requirements.
6. RIGA claims the County did not properly monitor the Project.
7. RIGA claims the County did not ensure that required audits were performed.
8. RIGA claims City Vest incurred an unreasonable and unnecessary expense.
9. RIGA claims the Project has not met designated National Objectives.

Luzerne County Response

1. The Sterling Project was undertaken as early as 1984 when City Vest, a non-profit Developer (not a Subrecipient) embarked on the process to save this historic property. The Project was the main focus on the Wilkes-Barre 1992 Downtown Development Plan and eventually support from numerous Federal, State and Local Agencies. Finally, the County authorized assistance for City Vest as an important economic development and potential job creator of benefit to both the City and County. The actual County benefit determination occurred on October 16, 2002 when the Project was presented to the then County Commissioners by the previous Director of the Office of Community Development..
2. As stated previously, actual restoration and financial planning began in earnest in 1984 and continued until 2010. Throughout the process the historic preservation of the Sterling was part of the effort since the property was and remains on the National Register of Historic Places. The new proposed development on a cleared site will go a long way toward the original employment target for County residents. The site and new development will carry a symbol of the historic nature of the property.
3. There is no program, Federal, State, or local that can equal the flexibility that CDBG local funding can provide. It is the only such program available to places like Luzerne County or Wilkes-Barre that have the remotest chance of preserving the local communities in our Country. Usually if a HUD supported program similar to CDBG is undertaken it is successful. Even the Sterling Project will be successful when the new developer begins their development and the accompanying jobs are created for County L/M citizens and eventually the property will be back on the tax rolls.
4. The Sterling Hotel Historic Preservation and Economic Revitalization Project has been fully supported by County and City Officials, as well as the Private sector for almost 30 years. Thousands public-private volunteer hours have been expended on this most important undertaking, not only to save the structure but to use it as revenue producing facility that the citizens of Luzerne County will treasure. Although the original plans have been amended, the County expects the new developer will be able to carry on the work already begun for the site and create the new jobs aimed at supporting the original goals and revitalize Wilkes-Barre, the County Seat of Luzerne County.
5. On 10/16/02, the former OCD Director appeared before the Luzerne County Commissioners to explain the County employment, economic, tax revenue, and historic preservation benefits from the Sterling revitalization project. The Staff evaluation and determination was made on 10/2/02. Both documents are located on the County files.
6. The County and the HUD Regional CPD Office monitored the Sterling Project on numerous

occasions over the past 10 years. This Project was undertaken by a non-profit developer and not a subrecipient. Every dollar that has been expended for this Project has been reviewed and monitored by County Staff. The County's Monitoring Plan is review annually and revisions are made as appropriate. Please note, City Vest is a non-profit developer and responsible for all phases of the work. The construction objectives of this development are out by the developer not the County OCD.

7. City Vest is a non Profit developer not a subrecipient, therefore they are not guided by 24 CFR Part 84. The County does however, review each City Vest invoice in detail and have the payments approved by the County Council and Manager (previously by the County Commissioners). The County Single Audit that covered City Vest was available but not requested during the review.
8. City Vest did what was necessary to gain clear title to the Sterling. Every dollar spent by City Vest as a non- profit developer was reasonable and necessary to carry out the Project. Over such a long period of time (almost 30 years) liens mounted and many unexpected issues surfaced. City Vest never wasted any funds awarded by the County for the Project. There were many roadblocks that surfaced and were dealt with by City Vest to achieve the near impossible tasks that went with this development. It was finally determined that to complete the Project, considering public safety and even more cost together with dangerous conditions that could be harmful to the general public as well as the builders that the Project was terminated and the Sterling will be demolished. The County is fortunate in the final analysis, to restart the Project and ultimately succeed in redeveloping the site to create the jobs for County citizens.
9. The Sterling Project actually qualifies under two different but compatible eligible activities. First, the Project is on the National Register of Historic Places and no matter what else happens the requirement to carry out that recognition and responsibility will be obtained by eliminating slum and blight. Alternately the County expects the Project will meet its intention to create the required Low-Moderate jobs as planned.

The County expects that recycled economic funds already invested in the Project will ultimately be salvaged to a large extent through low-moderate job creation. Do to the nature of the situation to impose a financial sanction would be counterproductive especially in light of the fact that BLDP funds have been recycled many times and have no clear relationship to current U.S. Treasury funds. The CDBG regulations allow for other than financial sanctions if guidance is required to be imposed.

Please do not hesitate contact me if you have any questions regarding this response.

Sincerely,

Andrew D. Reilly

cc: Jane C. W. Vincent
Nadab O. Bynum
Ileana Colon



U.S. Department of Housing and Urban Development

Philadelphia Office
The Wanamaker Building
100 Penn Square East
Philadelphia, Pennsylvania 19107-3380

MAR 21 2013

Mr. Andrew D. Reilly
Executive Director
Luzerne County Office of
Community Development
54 West Union Street
Wilkes-Barre, PA 18701

RECEIVED

MAR 25 2013

LUZERNE COUNTY
COMMUNITY DEVELOPMENT

Dear Mr. Reilly:

SUBJECT: HUD OIG Audit Report (2013-PH-1001)
Luzerne County, PA

This letter serves as a follow up to your letter of December 7, 2012, which was submitted in reply to the HUD Audit Report issued on October 13, 2012 by the Office of Inspector General for Audit, Philadelphia Region.

Based on our review, it has been determined that your reply does not address nor meet the requirements of the identified recommendations (1A, 1B and 1C) as identified on Page 15 of the Audit. As you are aware, the recommendations identified in the audit and which the County must adhere to, are as follows:

1A. Reimburse its business development loan program \$5,999,894 from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project.

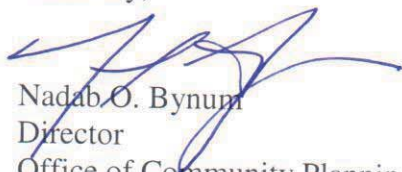
1B. Develop and implement comprehensive procedures for evaluating and underwriting proposed projects before approving applications for business development loans.

1C. Develop and implement comprehensive procedures for effectively monitoring Block Grant-assisted activities.

We ask that a response that identifies the County's Plan of Action for addressing Recommendations 1A, 1B, and 1C with a timeline for completion be provided to this Office within 30 days from the date of this letter.

We will work closely with the County as needed to determine the best course of action in meeting the requirements of the recommendations identified above. If you have any questions or require assistance, please contact Ms. Ileana Colón, Senior Community Planning and Development Representative, at (215) 861-7656, or via email at Ileana.Colon@hud.gov. This Office may also be reached via text telephone (TTY), by dialing (215) 656-3452.

Sincerely,



Nadab O. Bynum
Director
Office of Community Planning
and Development

ROBERT C. LAWTON
County Manager

ANDREW D. REILLY
Executive Director

COUNTY COUNCIL

TIM MCGINLEY, CHAIRMAN
LINDA MCCLOSKEY HOUCK, VICE CHAIRMAN
JAMES BOBECK
EDWARD A. BROMINSKI
ELAINE MADDON CURRY
HARRY HAAS
EUGENE L. KELLEHER
RICK MORELLI
STEPHEN A. URBAN
STEPHEN J. URBAN
RICK WILLIAMS

E-MAIL:
luzcood@luzemecounty.org



County of LUZERNE
P E N N S Y L V A N I A
ESTABLISHED 1786

OFFICE OF COMMUNITY DEVELOPMENT

54 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2910 TDD: 570.825.1860

April 17, 2013

Mr. Nadab O. Bynum
Director
Community Planning and Development
U.S. Department of Housing and Urban Development
The Wanamaker Building
100 Penn Square East
Philadelphia, PA 19107

RE: HUD OIG Audit Report (2013-PH-1001)

Dear Mr. Bynum:

This is to confirm receipt of the above-referenced letter on Monday, March 25, 2013 and our telephone conversation of Tuesday, March 26, 2013.

The conversation briefly summarized the County's December 7, 2012 letter and you indicated we should respond to your letter as written. You also indicated that HUD (Philadelphia and Washington) believed our December 7, 2012 letter did not adequately address the County's desire to waive/release the County from reimbursing the business development loan fund. It was our intention in formulating the December 7, 2012, response to address all the issues outlined in the audit in an attempt to present our views and correct the record.

The following represents a direct response and a Plan of Action per your request:

A. RECOMMENDATION 1C.

Develop and implement comprehensive procedures for effectively monitoring Block Grant-assisted activities.

RESPONSE:

We have been using HUD's monitoring procedures as set forth in CPD Handbook 6509.2, Rev. 6. A copy of a checklist with respect to applicable parts of the Handbook for "MONITORING" is enclosed. It is used for every loan.

B. RECOMMENDATION 1B.

Development and implement comprehensive procedures for evaluating and underwriting proposed projects before approving applications for business development loans.

RESPONSE:

We currently use a comprehensive procedure for evaluating and underwriting proposed projects before approval of loans. A copy of our guidelines was presented to OIG. Enclosed is a copy of the checklist required to be completed for every loan. Please note item 5 which addresses "Determination of Need" and "Financial Analysis".

C. RECOMMENDATION 1A.

Reimburse its business development loan program \$5,999,894 from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project.

RESPONSE:

We agree with your request that the present loan with CityVest should be concluded and will finalize this in IDIS within thirty (30) days.

Pursuant to the loan agreement, Luzerne County filed a lien against the property to secure the County's interests in 2002.

The Sterling is located in Wilkes-Barre within 2 city blocks of Public Square (the exact center of the downtown business district). The land has significant value for future development.

The Sterling project faced its greatest challenge with the failure of the economy in the 2006 – 2008 time frame. Financing dried up; tenants/users walked away. The expected on-going privately financed rehabilitation could not occur and the deterioration from 1988 to 2008 overwhelmed the project. So, irrespective of OIG claims, a differing result would be evident if times were good.

A chronology of CityVest's efforts which was available to OIG reveals the magnitude of the structural problems encountered and stated: "Every potential developer – including the firm that had signed the letter of intent – ultimately withdrew themselves from consideration. Some were unable to secure private financing; all of them identified prohibitively expensive costs to preserve the Hotel building and concerns about the viability of marketing new residential and/or commercial space in downtown Wilkes-Barre at price points that would cover the expense of the redevelopment costs."

Thus, in fact, the end result sought was not achieved. Effectively, the funds were spent on what truly was a "feasibility study", as well as acquisition and interim assistance to minimize safety issues, related to feasibility.

Since its inception, the Loan Program has funded 669 loans totaling \$235,690,576, with a CDBG investment of \$26.3 million, the last of which was drawn from Treasury in 2000 prior to any CityVest involvement. **These loans created 16,613 jobs, of which 12,921 are low/mod (78%), and 5,343 jobs were retained.** The cost per job is \$14,187.12.

Over the life of the loan fund (21 years), Luzerne County has performed admirably in its stewardship of the fund. Only four (4) loans have been delinquent. Only two (2) loans, less than 1%, have defaults (meaning the fund did not recover full principal).

The Loan Agreement establishes the parameters with respect to repayment and/or forgiveness. It states that, "if the Recipient (CityVest) has not commenced repayment within ten (10) years..., the County will restructure a repayment and/or forgiveness schedule ." This provision for all practical purposes means the County had to file its lien and ultimately formally forgive any balance due when the property is sold. Any receipts will be returned to the Loan Fund.

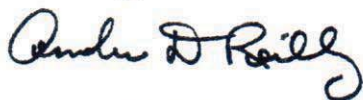
We believe a clear reading of the CityVest/County Agreement would have allowed forgiveness.

Luzerne County has never had a monetized finding. It has been a model in its Business Development Loan Fund operation. This "loan" was a follow-on to the earlier congressionally approved HUD grant for the initial loan for the same purpose. The intent and procedures of this second "loan" were consistent.

In order to proceed, we request HUD to release/waive any monetary response with respect to Recommendation 1A.

Please do not hesitate contact me if you have any questions regarding this response.

Sincerely,



Andrew D. Reilly

Attachment(s)

Exhibit 3-5
CDBG Entitlement Program

6509.2 REV-5 CHG-2

ENCLOSURE
TO
RECOMMENDATION
IC.

Guide for Review of National Objective of Low- and Moderate-Income Job Creation/Retention Activities			
Name of Program Participant:			
Staff Consulted:			
Activity Name, Number and Brief Description:			
Name(s) of Reviewer(s)		Date	

NOTE: All questions that address requirements contain the citation for the source of the requirement (statute, regulation, NOFA, or grant agreement). If the requirement is not met, HUD must make a finding of noncompliance. Except for questions "4.b," "8.b," and "9," all other questions (questions that do not contain the citation for the requirement) do not address requirements, but are included to assist the reviewer in understanding the participant's program more fully and/or to identify issues that, if not properly addressed, could result in deficient performance. Negative conclusions to these questions may result in a "concern" being raised, but not a "finding."

Instructions: Use this Exhibit for activities the program participant has classified as meeting the national objective of low- and moderate-income job creation/retention activities. The Exhibit is broken into ten sections. The reviewer may complete only those sections applicable to the subject activity as follows: Job Creation: Funding Start Date; Job Creation: Held By; Job Creation: Activity Incomplete; Job Creation: Completed Activity; Job Creation: Made Available To; Job Retention; If Two or More Years Have Elapsed Since the Provision of CDBG Assistance for Retained Jobs; If Less than Two Years Have Elapsed Since the Provision of CDBG Assistance for Retained Jobs; Report Validation; and Pre-1995 Public Benefit Standard Activities. One Exhibit is to be completed for each business that is reviewed except for an activity that involves job aggregation. If the jobs are to be counted in the aggregate, the provisions at 24 CFR 570.208(a)(4)(vi)(A) through (F) will apply. The reviewer is requested to refer to the paragraph that corresponds to the activity(s) undertaken, count the jobs accordingly, and make a determination of compliance. (Attach a separate sheet, if needed.) Also see Exhibit 3-12, Guide for Review of Individual Economic Development Activities, Section B.

Questions**A. JOB CREATION: FUNDING START DATE**

1.

What is the date (MM/DD/YY) when the CDBG assistance was first obligated for this activity?
Describe Basis for Conclusion:

6509.2 REV-5 CHG-2

Exhibit 3-5
CDBG Entitlement ProgramB. JOB CREATION: HELD BY

2.

a. If the assisted activity is to meet the national objective based on jobs being held by low- and moderate-income persons, is there a written agreement between the program participant and the assisted business that commits the business to have at least 51% of the jobs, on a full-time equivalent basis, to be held by low- and moderate-income persons? [24 CFR 570.506(b)(5)(ii)(A)(1)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			
b. Does the agreement contain a listing by job title of the permanent jobs to be created, identifying which are part-time, if any? [24 CFR 570.506(b)(5)(ii)(A)(2)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			
c. Does the program participant have a method or system for tracking the business's progress in meeting its responsibilities under the agreement?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			
d. If the activity includes part-time jobs, were they computed on a full-time equivalent (FTE) basis using 40 hours as an FTE (e.g., a 20 hour per week job equals 1/2 of a job)? [24 CFR 570.208(a)(4) and 24 CFR 570.506(b)(5)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

03/2008

3-2

Exhibit 3-5
CDBG Entitlement Program

6509.2 REV-5 CHG-2

e. If this activity includes temporary jobs, were they excluded from the job figures?
[24 CFR 570.208(a)(4) and 24 CFR 570.506(b)(5)]

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Yes	No	N/A

Describe Basis for Conclusion:

f. If the answers to either "2.d." or "2.e." are "no," calculate the correct number of jobs for this assisted activity, converting the part-time jobs to a full-time equivalent basis and/or omitting all temporary jobs.

Describe Basis for Conclusion:

C. JOB CREATION: ACTIVITY INCOMPLETE

(Note: If this activity is not yet complete, end review with question 3. If it is complete, skip to Section D. "Complete" means that all CDBG funds have been expended and the jobs to be created/retained as a result of the assistance have been realized.)

3.

a. If the activity is not complete (more jobs are expected to be created), what is the anticipated completion date?

Describe Basis for Conclusion:

b. Does it appear that the low- and moderate-income jobs commitment will be met?

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Yes	No	N/A

Describe Basis for Conclusion:

6509.2 REV-5 CHG-2

Exhibit 3-5
CDBG Entitlement ProgramD. JOB CREATION: COMPLETED ACTIVITY

4.

- a. If the activity is considered completed (i.e., all financial commitments have been expended and no additional jobs are expected to result from the CDBG- assisted activity), how many permanent FTE jobs were actually created?

Describe Basis for Conclusion:

- b. Were at least 51 percent of the permanent jobs created initially held by low- and moderate-income persons on a FTE basis? (Note: if the assisted activity can be shown to meet the "made available to" requirement in questions at 8.b. or 9. below, a finding cannot be made for this question.)
[24 CFR 570.208(a)(4)]

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Yes	No	N/A

Describe Basis for Conclusion:

5.

- a. Is there documentation showing a listing by job title of the permanent jobs filled and which jobs were initially held by low- and moderate-income persons?
[24 CFR 570.506(b)(5)(ii)(B)]

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Yes	No	N/A

Describe Basis for Conclusion:

- b. Is there documentation showing for each low- and moderate-income person hired the size and annual income of the person's family prior to the person being hired for the job OR is there documentation showing a presumed benefit was used, based on the census tract where the person resides or the business is located per 24 CFR 570.208(a)(4)(iv)(A) and/or (B)?
[24 CFR 570.506(b)(5)(ii)(C) or 24 CFR 570.506(b)(7)]

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Yes	No	N/A

Describe Basis for Conclusion:

03/2008

3-4

Exhibit 3-5 6509.2 REV-5 CHG-2
CDBG Entitlement Program

<p>c. Were the correct Section 8 income limits for family size and income used at the time the low- and moderate-income person applied and/or was hired for the job OR was the person presumed to be low and moderate income based on the census tract criteria set forth at 24 CFR 570.208(a)(4)(v), as applicable? [24 CFR 570.3 or 24 CFR 570.506(b)(1) and (7)]</p>	<table border="1"> <tr> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>Yes</td> <td>No</td> <td>N/A</td> </tr> </table>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Yes	No	N/A
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>					
Yes	No	N/A					
<p>Describe Basis for Conclusion:</p>							

E. JOB CREATION: TO BE MADE AVAILABLE TO LOW/MOD PERSONS (Note: If this option is not applicable, skip to Section F.)

6.

<p>a. If the assisted activity is to meet the national objective based on jobs being made "available to" low- and moderate-income persons, is there a written agreement between the program participant (or subrecipient) and the business that contains a commitment that the business will make at least 51 percent of the jobs available to low- and moderate-income persons and will provide training for any jobs requiring special skills and education? [24 CFR 570.506(b)(5)(i)(A)(1)]</p>	<table border="1"> <tr> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>Yes</td> <td>No</td> <td>N/A</td> </tr> </table>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Yes	No	N/A
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>					
Yes	No	N/A					
<p>Describe Basis for Conclusion:</p>							

<p>b. Does the written agreement contain: a listing by job title of the permanent jobs to be created; which jobs (if any) are part-time; which jobs will be made available to low- and moderate-income persons; and which of those jobs require special skills or education? [24 CFR 570.506(b)(5)(i)(A)(2)]</p>	<table border="1"> <tr> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> <td><input type="checkbox"/></td> </tr> <tr> <td>Yes</td> <td>No</td> <td>N/A</td> </tr> </table>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Yes	No	N/A
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>					
Yes	No	N/A					
<p>Describe Basis for Conclusion:</p>							

6509.2 REV-5 CHG-2

Exhibit 3-5
CDBG Entitlement Program

c. Does the written agreement contain a commitment by the business and a description of the actions to be taken by the recipient and the business to ensure that first consideration will be given to low- and moderate-income persons? [24 CFR 570.506(b)(5)(i)(A)(1) and (3)]	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No	N/A

Describe Basis for Conclusion:

d. How does the program participant track the business's progress in meeting its contractual responsibilities?
--

Describe Basis for Conclusion:

7.

a. Is there documentation that lists, by job title, the number of full-time-equivalent permanent jobs filled, and which of those jobs were made available to low- and moderate-income persons? [24 CFR 570.506(b)(5)(i)(B)]	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No	N/A

Describe Basis for Conclusion:

b. Is there documentation showing how first consideration was given to low- and moderate-income persons for these jobs? [24 CFR 570.506(b)(5)(i)(B)]	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No	N/A

Describe Basis for Conclusion:

03/2008

3-6

Exhibit 3-5
CDBG Entitlement Program

6509.2 REV-5 CHG-2

c. If the answer to "b" above is "yes," does the documentation include: what hiring process was used; which low- and moderate-income persons were interviewed for a particular job; and which low- and moderate-income persons were hired? [24 CFR 570.506(b)(5)(i)(B)]	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A
---	---

Describe Basis for Conclusion:

8.

a. Of the total number of jobs filled, how many jobs were made available to low- and moderate-income persons?

Describe Basis for Conclusion:

b. Were at least 51 percent of the jobs made available to low- and moderate-income persons? (Note: If the assisted activity is complete and did not meet the "held by" or "made available to" requirements in question "4.b." and this question, the reviewer must determine whether the completed activity can meet the national objective based on a combination of the "held by" and made available to" requirements per question "9" below. If the answer to question "9" is "yes," a finding cannot be made for this question.) [24 CFR 570.208(a)(4)(i)]	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A
---	---

Describe Basis for Conclusion:

c. Is there documentation showing, for each low- and moderate-income person hired, the size and annual income of the person's family prior to the job being made available to the person OR is there documentation showing a presumed benefit was used, based on the census tract where the person resides or the business is located per 24 CFR 570.208(a)(4)(iv)(A) and/or (B)? [24 CFR 570.506(b)(5)(ii)(C) or 24 CFR 570.506(b)(7)]	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A
--	---

Describe Basis for Conclusion:

3-7

03/2008

6509.2 REV-5 CHG-2

Exhibit 3-5
CDBG Entitlement Program

d. Were the correct Section 8 income limits for family size and income used at the time the low- and moderate-income person applied and/or was hired for the job OR was the person presumed to be low and moderate income based on the census tract criteria set forth at 24 CFR 570.208(a)(4)(v), as applicable? [24 CFR 570.3 or 24 CFR 570.506(b)(1) and (7)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

9.

Describe how the low- and moderate-income income status of an employee or applicant was determined or how the location of the employee or applicant or business was verified and documented. [24 CFR 570.3, 24 CFR 570.208(a)(4), 24 CFR 570.506(b)(5), or 24 CFR 570.506(b)(7)]
Describe Basis for Conclusion:

F. JOB CREATION: COMBINING "HELD BY" AND "AVAILABLE TO"

10.

If the activity is completed (no more jobs are expected to be created) and the 51 percent threshold was not met for either jobs held by, or made available to, low- and moderate-income persons, can the threshold be met by combining the number of jobs held by and made available to low- and moderate-income persons (taking care not to double count the jobs) on a permanent FTE basis in order to meet the national objective? [24 CFR 570.208(a)(4) and 24 CFR 570.506(b)(5)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

03/2008

3-8

Exhibit 3-5
CDBG Entitlement Program

6509.2 REV-5 CHG-2

G. JOB RETENTION (Note: If this option is not applicable, skip to Section I.)

11.

Did the program participant qualify the assisted activity on the basis of job retention?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No	N/A
Describe Basis for Conclusion:			

12.

Provide the month and year that the CDBG assistance was first provided to this activity.
Describe Basis for Conclusion:

13.

a. What evidence does the business have to show that jobs would have been lost without the CDBG assistance?
Describe Basis for Conclusion:

b. Does this evidence clearly and objectively show that jobs would have been lost without CDBG assistance? [24 CFR 570.208(a)(4)(ii) and 24 CFR 570.506(b)(6)(i)]	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No	N/A
Describe Basis for Conclusion:			

14.

How many FTE permanent jobs were retained?
Describe Basis for Conclusion:

15.

c. What is the basis for the job turnover projections?
[24 CFR 570.506(b)(6)(ii)]

Describe Basis for Conclusion:

16.

<p>a. Where jobs will be filled through job turnover, is there documentation that lists, by job title:</p> <ul style="list-style-type: none"> the permanent jobs; which jobs, if any, were part-time; which jobs required special skills or education; and which of those jobs were made available to low-and moderate-income persons? <p>NOTE: If the business is not using job turnover to qualify the activity, skip to question 17.</p> <p>[24 CFR 570.506(b)(6)(iv)]</p>	<div> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> </div> <div> Yes No N/A </div>
<p>Describe Basis for Conclusion:</p>	

3-10

6509.2 REV-5 CHG-2

17.

<p>a. Of the jobs retained per question 14, were at least 51 percent held by low- and moderate-income persons on a permanent FTE basis at the time the CDBG assistance was first provided? (Include percentage in "Basis for Conclusion" below.) <u>[24 CFR 570.208(a)(4)(ii)]</u></p>	<div style="display: flex; justify-content: space-around;"> <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A </div>
<p>Describe Basis for Conclusion:</p> <div style="border: 1px solid black; height: 100px; width: 100%;"></div>	

<p>b. Is there documentation showing, for each low- and moderate-income job retained, the size and annual income of the person's family at the time the job was proposed to be retained?</p> <p>[24 CFR 570.506(b)(6)(iii) or 24 CFR 570.506(b)(7)]</p>	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
<p>Describe Basis for Conclusion:</p>			

Exhibit 3-5
CDBG Entitlement Program

<p>c. If the answer to "b" above is "no" or "N/A," is there documentation showing a presumed benefit was used, based on the census tract where the person resides or where the business is located?</p> <p>[24 CFR 570.208(a)(4)(iv)(A) and/or (B)]</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p> <p>Yes No N/A</p>
<p>Describe Basis for Conclusion:</p>	
<p>d. Were the correct Section 8 income limits for family size and income used at the time the CDBG assistance was first provided OR is there documentation showing the person may be presumed to be low and moderate income based on the census tract criteria set forth at 24 CFR 570.208(a)(4)(v), as applicable?</p> <p>[24 CFR 570.3 or 24 CFR 570.506(b) and (7)]</p>	<p><input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/></p> <p>Yes No N/A</p>
<p>Describe Basis for Conclusion:</p>	

H. IF TWO OR MORE YEARS HAVE ELAPSED SINCE THE PROVISION OF CDBG ASSISTANCE FOR RETAINED JOBS

18.

a. How many retained jobs have turned over?

Describe Basis for Conclusion:

b. Of the jobs listed in "a" above, were steps taken, per the written agreement, to ensure they were made available to low- and moderate-income persons on a permanent FTE basis during the two-year period? (Exclude those jobs held by low- and moderate-income persons when the CDBG assistance was first provided, as shown in question "17.a" above.)

[24 CFR 570.506(b)(6)(ii)]

Describe Basis for Conclusion:

03/2008

3-12

Exhibit 3-5
CDBG Entitlement Program

6509.2 REV-5 CHG-2

c. Was the 51 percent requirement met? [24 CFR 570.208(a)(4)(ii)(A) and (B) and 24 CFR 570.506(b)(6)(ii)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

d. Is there documentation showing, for each low- and moderate-income person retained, the size and annual income of the person's family prior to the person being hired for the job OR is there documentation showing a presumed benefit was used, based on the census tract where the person resides or the business is located per 24 CFR 570.208(a)(4)(iv)(A) and/or (B)? [24 CFR 570.506(b)(6)(iii) or 24 CFR 570.506(b)(1) or (7)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

e. Were the correct Section 8 income limits for the family applied at the time the low- and moderate-income person was retained OR was the person presumed to be low and moderate income based on the census tract criteria set forth at 24 CFR 570.208(a)(4)(v), as applicable? [24 CFR 570.3 or 24 CFR 570.506(b)(7)]	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> N/A
Describe Basis for Conclusion:			

I. IF LESS THAN TWO YEARS HAVE ELAPSED SINCE THE PROVISION OF CDBG ASSISTANCE FOR RETAINED JOBS

19.

a. How many of the retained jobs (excluding those known to be held by low- and moderate-income persons at the time CDBG assistance was first provided, as shown in question "17.a.") are projected to become available to low- and moderate-income persons through job turnover within two years of the time the CDBG assistance was provided? [24 CFR 570.506(b)(6)(ii)]
Describe Basis for Conclusion:

REAL ESTATE / ECONOMIC DEVELOPMENT COMMITTEE; APRIL 8, 2014 ITEM 6(H)

6509.2 REV-5 CHG-2

Exhibit 3-5
CDBG Entitlement Program

b. Does the projected amount appear to be reasonable?	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No
Describe Basis for Conclusion:		

J. REPORT VALIDATION

20.

Did your review of the records validate the information and number of jobs provided by the program participant in the Integrated Disbursements and Information System (IDIS) and/or the most recently completed (or applicable) Consolidated Annual Performance and Evaluation Reports? [24 CFR 91.520(c) and 91.525(a)(3)]	<input type="checkbox"/>	<input type="checkbox"/>
	Yes	No
Describe Basis for Conclusion:		

03/2008

3-14

LUZERNE COUNTY BUSINESS DEVELOPMENT
APPLICATION CHECKLIST

1. B,

Recipient's Name: _____ Loan Number: BDLP-

Total Loan Amount: \$ _____ BDL Loan: \$ _____ Rate: _____ % Term: _____ Years

☒ 1. Application reviewed and the following items were found to be complete:

- ☐ Developer Information
- ☐ Current Operations
- ☐ Project Description
- ☐ Site Location and Map
- ☐ Demonstration of Need
- ☐ Description of Use of County Funds, including estimates or appraisals
- ☐ Project Budget
- ☐ Performance Schedule
- ☐ Employment Summary and Budget **It is important that the necessary jobs reflected on this form coincide with the generally accepted rule of one (1) job for every \$35,000 in loan funds.
- ☐ Proposed Expenditures
- ☐ 3-Year Projected Cash Flow Statement/Projected Cash Flow Statement
- ☐ 3-Year Projected Income Statement/Projected Income Statement
- ☐ 3-Year Projected Balance Sheet/Projected Balance Sheet
- ☐ Lender's Firm Commitment Letter
- ☐ Signed Assurances

Any changes to the above items after the application is received by this Office must be confirmed in writing by the Developer.

☐ 2. Advertisement for Public Meeting☐ 3. Loan approved by Commissioners and Preliminary Approval letter mailed.☐ 4. Signed Preliminary Approval and deposit of Processing Fee received.☐ 5. Completed OCD Forms

- ☐ Fact Sheet
- ☐ Pre-screening Form
- ☐ Employment Compliance Checklist
- ☐ Determination of Need
- ☐ Financial Analysis
- ☐ Environmental Assessment
- ☐ Flood Maps
- ☐ Agreement Prepared
- ☐ IDIS Set-up
- ☐ Closing Notice
- ☐ Signed Signature Page
- ☐ Signed Section 5.03

☐ 6. The following documents have been submitted by the Lender and reviewed:

- ☐ Letter of Credit, Mortgage, etc....
- ☐ Developer's Certification to Draw Funds and Invoice(s)
- ☐ Notification to Draw Funds - If a request for a check is received via telephone, the Counselor must complete a Verbal Request for Draw of Funds form and submit it to the Accounting Department. Please note that the Lender must still complete and submit the Notification to Draw Funds form.

☐ 7. OCD Approval Form signed by Counselor☐ 8. Submission of documents in #6 above to Accounting Department for processing of payment along with closing notice

Pt. 570, App. A

24 CFR Ch. V (4-1-10 Edition)

the material issues of fact, law or discretion presented on the record and the appropriate sanction or denial thereof. The decision shall be based on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. A copy of the decision shall be furnished to the parties immediately by certified mail, return receipt requested, and shall include a notice that any requests for review by the Secretary must be made in writing to the Secretary within 30 days of the receipt of the decision.

(8) *The record.* The transcript of testimony and exhibits, together with the decision of the ALJ and all papers and requests filed in the proceeding, constitutes the exclusive record for decision and, on payment of its reasonable cost, shall be made available to the parties. After reaching his/her initial decision, the ALJ shall certify to the complete record and forward the record to the Secretary.

(9) *Review by the Secretary.* The decision by the ALJ shall constitute the final decision of the Secretary unless, within 30 days after the receipt of the decision, either the respondent or the Assistant Secretary for Community Planning and Development files an exception and request for review by the Secretary. The excepting party must transmit simultaneously to the Secretary and the other party the request for review and the basis of the party's exceptions to the findings of the ALJ. The other party shall be allowed 30 days from receipt of the exception to provide the Secretary and the excepting party with a written reply. The Secretary shall then review the record of the case, including the exceptions and the reply. On the basis of such review, the Secretary shall issue a written determination, including a statement of the reasons or basis therefor, affirming, modifying or revoking the decision of the ALJ. The Secretary's decision shall be made and transmitted to the parties within 80 days after the decision of the ALJ was furnished to the parties.

(10) *Judicial review.* The respondent may seek judicial review of the Sec-

retary's decision pursuant to section 111(c) of the Act.

[53 FR 34466, Sept. 6, 1988, as amended at 64 FR 3802, Jan. 25, 1999]

APPENDIX A TO PART 570—GUIDELINES AND OBJECTIVES FOR EVALUATING PROJECT COSTS AND FINANCIAL REQUIREMENTS

I. *Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.* HUD has developed the following guidelines that are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects which are financially viable and will make the most effective use of the CDBG funds. *The use of these underwriting guidelines as published by HUD is not mandatory.* However, grantees electing not to use these underwriting guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business. States electing not to use these underwriting guidelines would be expected to ensure that the state or units of general local government conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.

II. Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a microenterprise or other small business to take into account the differences in the capacity and level of sophistication among businesses of differing sizes.

III. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. For example, a recipient administering a program providing only technical assistance to small businesses might choose to apply underwriting guidelines to the technical assistance program as a whole, rather than to each instance of assistance to a business. Given the nature and dollar value of such a program, a recipient might choose to limit its evaluation to factors such as the extent of need for this type of assistance by the target group of businesses and the extent to which this type of assistance is already available.

IV. The objectives of the underwriting guidelines are to ensure:

- (1) that project costs are reasonable;
- (2) that all sources of project financing are committed;
- (3) that to the extent practicable, CDBG funds are not substituted for non-Federal financial support;
- (4) that the project is financially feasible;

Ofc. of Asst. Secy., Comm. Planning, Develop., HUD

Pt. 570, App. A

(5) that to the extent practicable, the return on the owner's equity investment will not be unreasonably high; and

(6) that to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

i. *Project costs are reasonable.* i. Reviewing costs for reasonableness is important. It will help the recipient avoid providing either too much or too little CDBG assistance for the proposed project. Therefore, it is suggested that the grantee obtain a breakdown of all project costs and that each cost element making up the project be reviewed for reasonableness. The amount of time and resources the recipient expends evaluating the reasonableness of a cost element should be commensurate with its cost. For example, it would be appropriate for an experienced reviewer looking at a cost element of less than \$10,000 to judge the reasonableness of that cost based upon his or her knowledge and common sense. For a cost element in excess of \$10,000, it would be more appropriate for the reviewer to compare the cost element with a third-party, fair-market price quotation for that cost element. Third-party price quotations may also be used by a reviewer to help determine the reasonableness of cost elements below \$10,000 when the reviewer evaluates projects infrequently or if the reviewer is less experienced in cost estimations. If a recipient does not use third-party price quotations to verify cost elements, then the recipient would need to conduct its own cost analysis using appropriate cost estimating manuals or services.

ii. The recipient should pay particular attention to any cost element of the project that will be carried out through a non-arms-length transaction. A non-arms-length transaction occurs when the entity implementing the CDBG assisted activity procures goods or services from itself or from another party with whom there is a financial interest or family relationship. If abused, non-arms-length transactions misrepresent the true cost of the project.

2. *Commitment of all project sources of financing.* The recipient should review all projected sources of financing necessary to carry out the economic development project. This is to ensure that time and effort is not wasted on assessing a proposal that is not able to proceed. To the extent practicable, prior to the commitment of CDBG funds to the project, the recipient should verify that: sufficient sources of funds have been identified to finance the project; all participating parties providing those funds have affirmed their intention to make the funds available; and the participating parties have the financial capacity to provide the funds.

3. *Avoid substitution of CDBG funds for non-Federal financial support.* i. The recipient should review the economic development project to ensure that, to the extent prac-

ticable, CDBG funds will not be used to substantially reduce the amount of non-Federal financial support for the activity. This will help the recipient to make the most efficient use of its CDBG funds for economic development. To reach this determination, the recipient's reviewer would conduct a financial underwriting analysis of the project, including reviews of appropriate projections of revenues, expenses, debt service and returns on equity investments in the project. The extent of this review should be appropriate for the size and complexity of the project and should use industry standards for similar projects, taking into account the unique factors of the project such as risk and location.

ii. Because of the high cost of underwriting and processing loans, many private financial lenders do not finance commercial projects that are less than \$100,000. A recipient should familiarize itself with the lending practices of the financial institutions in its community. If the project's total cost is one that would normally fall within the range that financial institutions participate, then the recipient should normally determine the following:

A. *Private debt financing*—whether or not the participating private, for-profit business (or other entity having an equity interest) has applied for private debt financing from a commercial lending institution and whether that institution has completed all of its financial underwriting and loan approval actions resulting in either a firm commitment of its funds or a decision not to participate in the project; and

B. *Equity participation*—whether or not the degree of equity participation is reasonable given general industry standards for rates of return on equity for similar projects with similar risks and given the financial capacity of the entrepreneur(s) to make additional financial investments.

iii. If the recipient is assisting a microenterprise owned by a low- or moderate-income person(s), in conducting its review under this paragraph, the recipient might only need to determine that non-Federal sources of financing are not available (at terms appropriate for such financing) in the community to serve the low- or moderate-income entrepreneur.

4. *Financial feasibility of the project.* i. The public benefit a grantee expects to derive from the CDBG assisted project (the subject of separate regulatory standards) will not materialize if the project is not financially feasible. To determine if there is a reasonable chance for the project's success, the recipient should evaluate the financial viability of the project. A project would be considered financially viable if all of the assumptions about the project's market share, sales levels, growth potential, projections of revenue, project expenses and debt service (including repayment of the CDBG assistance if

Pt. 572

24 CFR Ch. V (4-1-10 Edition)

appropriate) were determined to be realistic and met the project's break-even point (which is generally the point at which all revenues are equal to all expenses). Generally speaking, an economic development project that does not reach this break-even point over time is not financially feasible. The following should be noted in this regard:

A. some projects make provisions for a negative cash flow in the early years of the project while space is being leased up or sales volume built up, but the project's projections should take these factors into account and provide sources of financing for such negative cash flow; and

B. it is expected that a financially viable project will also project sufficient revenues to provide a reasonable return on equity investment. The recipient should carefully examine any project that is not economically able to provide a reasonable return on equity investment. Under such circumstances, a business may be overstating its real equity investment (actual costs of the project may be overstated as well), or it may be overstating some of the project's operating expenses in the expectation that the difference will be taken out as profits, or the business may be overly pessimistic in its market share and revenue projections and has downplayed its profits.

ii. In addition to the financial underwriting reviews carried out earlier, the recipient should evaluate the experience and capacity of the assisted business owners to manage an assisted business to achieve the projections. Based upon its analysis of these factors, the recipient should identify those elements, if any, that pose the greatest risks contributing to the project's lack of financial feasibility.

5. *Return on equity investment.* To the extent practicable, the CDBG assisted activity should provide not more than a reasonable return on investment to the owner of the assisted activity. This will help ensure that the grantee is able to maximize the use of its CDBG funds for its economic development objectives. However, care should also be taken to avoid the situation where the owner is likely to receive too small a return on his/her investment, so that his/her motivation remains high to pursue the business with vigor. The amount, type and terms of the CDBG assistance should be adjusted to allow the owner a reasonable return on his/her investment given industry rates of return for that investment, local conditions and the risk of the project.

6. *Disbursement of CDBG funds on a pro rata basis.* To the extent practicable, CDBG funds used to finance economic development activities should be disbursed on a pro rata basis with other funding sources. Recipients should be guided by the principle of not placing CDBG funds at significantly greater risk than non-CDBG funds. This will help avoid

the situation where it is learned that a problem has developed that will block the completion of the project, even though all or most of the CDBG funds going in to the project have already been expended. When this happens, a recipient may be put in a position of having to provide additional financing to complete the project or watch the potential loss of its funds if the project is not able to be completed. When the recipient determines that it is not practicable to disburse CDBG funds on a pro rata basis, the recipient should consider taking other steps to safeguard CDBG funds in the event of a default, such as insisting on securitizing assets of the project.

[60 FR 1553, Jan. 5, 1995]

PART 572—HOPE FOR HOMEOWNERSHIP OF SINGLE FAMILY HOMES PROGRAM (HOPE 3)

Subpart A—General

Sec.

572.1 Overview of HOPE 3.

572.5 Definitions.

572.10 Section 8 assistance.

Subpart B—Homeownership Program Requirements—Implementation Grants

572.100 Acquisition and rehabilitation of eligible properties; rehabilitation standards.

572.105 Financing the purchase of properties by eligible families.

572.110 Identifying and selecting eligible families for homeownership.

572.115 Transfer of homeownership interests.

572.120 Affordability standards.

572.125 Replacement reserves.

572.130 Restrictions on resale by initial homeowners.

572.135 Use of proceeds from sales to eligible families, resale proceeds, and program income.

572.140 Third party rights.

572.145 Displacement prohibited; protection of nonpurchasing residents.

Subpart C—Grants

572.200 Planning grants.

572.205 Planning grants—eligible activities.

572.210 Implementation grants.

572.215 Implementation grants—eligible activities.

572.220 Implementation grants—matching requirements.

572.225 Grant agreements; corrective and remedial actions.

572.230 Cash and Management Information (CMI) System.

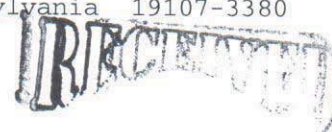
572.235 Amendments.



U.S. Department of Housing and Urban Development

Philadelphia Office
The Wanamaker Building
100 Penn Square East
Philadelphia, Pennsylvania 19107-3380

JAN 24 2014



JAN 25 2014



Mr. Andrew D. Reilly
Executive Director
Luzerne County Office of
Community Development
54 West Union Street
Wilkes-Barre, PA 18711

Dear Mr. Reilly:

SUBJECT: Luzerne County, PA-Audit Report 2013-PH-1001

This letter is a response to your letter dated April 17, 2013 in which the County has responded to our letter dated March 25, 2013 where our Office has requested that the County address the specific actions planned to address Recommendations 1A, 1B, and 1C outlined in the Audit Report issued on October 13, 2012 by the Regional Inspector General for Audit, Philadelphia Region.

Based on our review of your response dated April 17, 2013 in addition to follow up information received via email on January 8, 2014 we have determined the following:

RECOMMENDATION 1A.

Reimburse its business development loan program \$5,999,894 from non-Federal funds for the ineligible expenditures related to the Hotel Sterling project.

County Response:

The County agreed with HUD's request that the present loan with CityVest should be concluded and the County agreed to finalize the activity in IDIS within thirty (30) days.

Pursuant to the loan agreement, Luzerne County filed a lien against the property to secure the County's interests in 2002. The Sterling is located in Wilkes-Barre within two city blocks of Public Square (the exact center of the downtown business district). The land has significant value for future development.

The Sterling project faced its greatest challenge with the failure of the economy in the 2006 — 2008 time frame, where financing dried up and tenants/users walked away. The expected on-going privately financed rehabilitation could not occur and the deterioration from 1988 to 2008 overwhelmed the project. So, irrespective of OIG claims, a differing result would be evident if times were good.

A chronology of CityVest's efforts which was available to OIG reveals the magnitude of the structural problems encountered leading to all potential developers withdrawing themselves from consideration. Thus, in fact, the end result sought was not achieved. Effectively, the funds were spent on what truly was a "feasibility study", as well as acquisition and interim assistance to minimize safety issues, related to feasibility.

The Loan Agreement establishes the parameters with respect to repayment and/or forgiveness. It states that, "if the Recipient (CityVest) has not commenced repayment within ten (10) years..., the County will restructure a repayment and/or forgiveness schedule." This provision for all practical purposes means the County had to file its lien and ultimately formally forgive any balance due when the property is sold. Any receipts will be returned to the Loan Fund.

The County believes a clear reading of the CityVest/County Agreement would have allowed forgiveness.

Luzerne County has never had a monetized finding. It has been a model in its Business Development Loan Fund operation. This "loan" was a follow-on to the earlier congressionally approved HUD grant for the initial loan for the same purpose. The intent and procedures of this second "loan" were consistent.

In order to proceed, the County requests HUD to release/waive any monetary response with respect to Recommendation 1A.

HUD Response:

HUD is unable approve the County's request for a waiver of the repayment of funds for an activity that did not meet a national objective. Based on the evidence provided by the County, the Hotel Sterling Activity did not produce low-mod jobs and therefore did not meet a national objective.

The CDBG regulations at 24 CFR 208 (a) - *Activities benefiting low- and moderate-income persons* note that "activities meeting the criteria in paragraph (a) (1), (2), (3), or (4) of this section as applicable, will be considered to benefit low and moderate income persons unless there is substantial evidence to the contrary." Based on the information provided by the County, the Office of Community Planning and Development has determined that the County is not in compliance with CDBG national objective requirements and must therefore concur with the recommendation made by the Office of Inspector General. The County must reimburse its business development loan program \$5,999,894 from non-Federal funds for the expenditures related to the Hotel Sterling project.

RECOMMENDATION 1B.

Development and implement comprehensive procedures for evaluating and underwriting proposed projects before approving applications for business development loans.

County Response:

The County is currently using a comprehensive procedure for evaluating and underwriting proposed projects before approval of loans. A copy of the guidelines was presented to OIG and are also on file with the Office of Community Planning and Development. Additionally, the County provided a copy of the checklist required to be completed for every loan - Item 5 addresses "Determination of Need" and "Financial Analysis".

HUD Response:

Based on our review, we have determined that the information provided adequately addresses the recommendation. The Office of Community Planning and Development will recommend that OIG close this finding and will advise the County of the results of our request.

RECOMMENDATION 1C.

Develop and implement comprehensive procedures for effectively monitoring Block Grant-assisted activities.

County Response:


The County uses HUD's monitoring procedures as set forth in CPD Handbook 6509.2, Rev. 6. A copy of a checklist with respect to applicable parts of the Handbook for "MONITORING" was provided. It is used for every loan. Additionally, an email was received on January 8, 2014, whereby the County provided a copy of the monitoring policies and procedures for the Business Development Loan Program.

HUD Response:

Based on our review, we have determined that the information provided adequately addresses the recommendation. The Office of Community Planning and Development will recommend that OIG close this finding and will advise the County of the results of our request.

We ask that a response be provided to this Office within 30 days from the date of this letter advising of the County's plan for reimbursement of funds. We are available to discuss with the County options and process for reimbursing funds that may include a voluntary grant reduction and/or repayments. If you have any questions or require assistance, please contact Ms. Ileana Colón, Senior Community Planning and Development Representative, at (215) 861-7656, or via email at Ileana.Colon@hud.gov. This Office may also be reached via telephone (TTY), by dialing (215) 656-3452.

Sincerely,



Nadah O. Bynum
Director
Office of Community Planning
and Development

ROBERT C. LAWTON
County Manager

ANDREW D. REILLY
Executive Director

COUNTY COUNCIL

RICK MORELLI, CHAIRMAN
EDWARD BROMINSKI, VICE CHAIRMAN
JAMES BOBECK
KATHY DOBASH
HARRY HAAS
LINDA MCCLOSKEY HOUCK
TIM MCGINLEY
EILEEN SOROKAS
STEPHEN A. URBAN
STEPHEN J. URBAN
RICK WILLIAMS

E-MAIL:
luzcood@luzernecounty.org



COUNTY of LUZERNE
P E N N S Y L V A N I A
ESTABLISHED 1786

OFFICE OF COMMUNITY DEVELOPMENT

54 WEST UNION STREET, WILKES-BARRE, PA 18701
O: 570.824.7214 F: 570.829.2910 TDD: 570.825.1860

January 30, 2014

Mr. Nadab O. Bynum
Director
Community Planning and Development
U.S. Department of Housing and Urban Development
The Wanamaker Building
100 Penn Square East
Philadelphia, PA 19107

**RE: Meeting Request
Luzerne County, PA-Audit Report 2013-PH-1001**

Dear Mr. Bynum:

Per our phone conversation and your suggestion of January 29, 2014 I am writing to request a meeting with you and officials of the HUD Office in Washington, D.C.

As you are aware per our discussions, I believe that major legal elements related to the City Vest-Hotel Sterling matter have been ignored or misunderstood and that HUD has jumped to the conclusion of a monetized settlement. It is my hope that a meeting will help clarify these issues.

In addition, I am requesting the involvement of Luzerne County's Congressional delegation and ask that they participate in the proposed meeting.

Sincerely,


Andrew D. Reilly

cc: Senator Robert Casey
Senator Pat Toomey
Representative Matt Cartwright
Representative Lou Barletta
Representative Tom Marino